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MICHAEL RODAK, JR.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1323

GENERAL MOTORS ACCEPTANCE CORPORATION AND DAVE WAITE PONTIAC, INC.,

Petitioners,

vs.

WILLARD D. EASON, M. O. SATROM, AND JEAN M. SATROM,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The petitioners request that a Writ of Certiorari issue to review the judgment of the Court of Appeals for the Seventh Circuit entered in the above cause on December 28, 1973.

OPINIONS BELOW

The opinion of the Court of Appeals has not been reported. A copy is appended as *Appendix I.* No opinion was written by the District Court but copies of its orders sustaining petitioners' motions to dismiss respondents' action for want of standing to maintain it under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder by the Securities Exchange Commission are appended as *Appendix II.*

JURISDICTION

The judgment of the Court of Appeals was entered December 28, 1973. A petition for rehearing was filed by petitioners January 11, 1974, and was denied January 23, 1974. See *Appendix I*. The jurisdiction of this Court is invoked under 28 U. S. C. §§ 1254(1) and 2101(c).

QUESTION PRESENTED

The question presented for review is whether, notwithstanding respondents were neither purchasers nor sellers of any security, they may nevertheless maintain a private action under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder by the Securities Exchange Commission.

STATUTE AND REGULATION INVOLVED

Section 10(b) of the Securities Act of 1934, 48 Stat. 891, 15 U. S. C. § 78j(b) provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * * * *
>
> "(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange, or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5 provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> "(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 C. F. R. § 240. 10b-5.

STATEMENT OF THE CASE INCLUDING BASIS FOR FEDERAL JURISDICTION

The petitioners are General Motors Acceptance Corporation ("GMAC"), a New York corporation, and Dave Waite Pontiac, Inc. ("Waite Pontiac"), an Indiana corporation and a General Motors Corporation ("GM") automobile dealer which, prior to the transactions involved here, also operated an automobile leasing division ("Waite Leasing"). GMAC is engaged principally in the business of financing the acquisition by dealers for resale of new products manufactured by GM and acquiring from such dealers retail installment obligations covering sales (including certain leasing transactions) of new products. At the time of the transactions involved here, GMAC held numerous chattel mortgage notes executed by Waite Pontiac in connection with the purchase of automobiles for use in Waite Leasing's operation.

The respondents are shareholders of Bank Service Corporation ("Bank Service"), an Indiana corporation. The amended complaint[1] alleges that on or about October 31, 1969, Bank Service, as the buyer, entered into a written contract with Waite Pontiac, as the seller, for the purchase of Waite Leasing. By the terms of the contract, Bank Service assumed Waite Pontiac's existing chattel mortgage indebtedness to GMAC and agreed to

1. The certified record filed in this Court includes as Document No. 1 Appellants' Appendix filed October 10, 1972, in the Court of Appeals for the Seventh Circuit. Record references herein are to that Appendix.

transfer to Waite Pontiac 7,000 shares of Bank Service stock of an agreed value of one dollar ($1.00) per share. (R., p. 5A; Ex. A, pp. 14A-18A.) The contract also contained a provision that the shareholders of Bank Service would agree to indemnify Waite Pontiac against liability to GMAC on account of the chattel mortgage indebtedness of Waite Pontiac which Bank Service had assumed and agreed to pay, and the shareholders, including respondents, who were its principal shareholders, officers and directors, therefore executed as an addendum to the contract a separate covenant agreeing to indemnify Waite Pontiac against liability to GMAC. (R., p. 18A.) GMAC was not a party to the purchase contract.

The amended complaint further alleges that GMAC agreed to permit the transfer of the assets of the leasing operation to Bank Service, and to finance a new leasing operation to be conducted by Bank Service, and/or its wholly owned subsidiary General Auto Leasing & Rental Corporation ("GAL"), upon condition that persons of substantial financial worth would guarantee payment to GMAC of the existing obligations assumed by Bank Service and of any future obligations of Bank Service or such wholly owned subsidiary. (R., p. 4A.)

In order to comply with the above condition, respondents, in a transaction distinct from the sale described above, executed and delivered to GMAC two separate written guarantees. In the first, respondents guaranteed the payment by Bank Service of all indebtedness owing or to be owed to GMAC (R. Ex. C, pp. 22A-24A), while in the second, respondents guaranteed payment by GAL of all obligations owed or to be owed by it to GMAC (R. Ex. B, pp. 19A-21A). Waite Pontiac is not alleged to have been a party to the credit transaction between respondents and GMAC.

Waite Pontiac and GMAC are alleged to have violated § 10(b) of the Securities Exchange Act and Rule 10b-5 during the negotiations between Bank Service, GMAC and Waite Pontiac by having made untrue statements of material facts and

by having failed to state material facts with respect to the business, the financial condition and the properties of Waite Pontiac and Waite Leasing, thereby concealing from respondents and Bank Service material adverse conditions of such business, financial position and properties, and also by having withheld information concerning certain policies and practices of the management of Waite Pontiac, GMAC and GM which should have been revealed.

Bank Service and/or GAL allegedly conducted the purchased leasing business for more than a year and a half at which time they became insolvent by reason of alleged operating losses. Thereafter, GMAC brought a state court action against respondents on the guaranties, in which respondents counterclaimed for damages and rescission of their guaranties, which remains pending. Respondents then commenced this federal court action against petitioners, jurisdiction being asserted under § 27 of the Securities Exchange Act of 1934, 15 U. S. C. § 78aa. The respondents' amended complaint in this action seeks to recover compensatory and punitive damages, and to have the guaranties and all evidences of indebtedness relating thereto rescinded and declared void.

The District Court for the Southern District of Indiana sustained petitioner's motions to dismiss on the ground that respondents, under their own allegations, were neither purchasers nor sellers of securities and consequently lacked standing to maintain this action under the rule originally enunciated in *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461 (2d Cir.), *cert. denied*, 343 U. S. 956 (1952), that only purchasers or sellers of securities may maintain a private action under § 10(b) and Rule 10b-5.

The Court of Appeals for the Seventh Circuit did not disagree with the District Court's conclusion that respondents were neither purchasers nor sellers of securities in the context of the described transactions. Nevertheless, it reversed the decision of the District Court. The Court of Appeals held that the *Birnbaum* purchaser-seller requirement is no part of the law of the Seventh

Circuit and that respondents therefore were entitled to maintain their § 10(b) and Rule 10b-5 action notwithstanding they were neither purchasers nor sellers of securities. The rationale of the Court of Appeals in reversing the judgment of the District Court was that under the allegations of the complaint, the transfer of the Bank Service stock to Waite Pontiac constituted a sale of securities in violation of § 10(b) and Rule 10b-5 as a result of which Bank Service could have maintained an appropriate action under the statute and rule; that although respondents were not the sellers of said stock, they were shareholders of Bank Service and presumably executed the guaranties on account of their interest as such shareholders; and that since such execution is alleged to have been induced by the same fraud or deceit which allegedly induced Bank Service to sell its stock, they are "persons" upon whom the acts of the petitioners operated as fraud or deceit "in connection with the purchase or sale of any security," although they were neither purchasers nor sellers either of the securities involved in connection with the alleged rule violation or of any other securities.

REASONS FOR GRANTING THE WRIT

1. The Decision of the Court of Appeals for the Seventh Circuit Is in Conflict with the Decision of Every Other Court of Appeals That Has Considered the Birnbaum Doctrine.

The decision of the Court of Appeals for the Seventh Circuit in this case is in conflict with the decision of every other Court of Appeals that has considered the purchaser-seller requirement for standing to sue under § 10(b) of the Securities Exchange Act and Rule 10b-5 of the Securities Exchange Commission.[2]

2. See *Landy* v. *Federal Deposit Insurance Corporation*, 486 F. 2d 139, 152-59 (3rd Cir. 1973), *petition for certiorari filed*, 42 U. S. L. W. 3336 (No. 73-819, November 23, 1973); *Haberman* v. *Murchison*, 468 F. 2d 1305, 1311 (2d Cir. 1972); *Mount Clemens Industries, Inc.* v. *Bell*, 464 F. 2d 339 (9th Cir. 1972); *Dudley* v. *Southeastern Factor and Finance Corp.*, 446 F. 2d 303

The decision here represents the first instance in which a court of appeals has rejected the view, initially set forth in *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461, 464 (2d Cir.), *cert. denied*, 343 U. S. 956 (1952), that Rule 10b-5 "extended protection only to the defrauded purchaser or seller." The Seventh Circuit made its position abundantly clear with its conclusion in this case that the purchaser-seller limitation "is not part of the law of this circuit." (App. I. p. A13.)

Continued efforts in recent years both by litigants, and by the Securities Exchange Commission as amicus curiae, to obtain repudiation of the *Birnbaum* purchaser-seller limitation have caused a number of the Courts of Appeals to review the question, but prior to this case such efforts have been notably unsuccessful. Only recently the *Birnbaum* rule was reaffirmed by the Court of Appeals for the Third Circuit in *Landy* v. *Federal Deposit Insurance Corporation*, 486 F. 2d 139 (1973), *petition for certiorari filed*, 42 U. S. L. W. 3336 (No. 73-819, November 23, 1973), where the court explained as follows:

> "Although various courts and commentators have suggested elimination of the purchaser-seller requirement, each of the circuit courts of appeals that has ruled on this question recently has affirmed the basic *Birnbaum* rule that standing under 10b-5 in a suit *for damages* requires purchaser-seller status.[3] The reasons for retaining

(5th Cir.), *cert. denied*, 404 U. S. 858 (1971); *Herpich* v. *Wallace*, 430 F. 2d 792 (5th Cir. 1970); *Simmons* v. *Wolfson*, 428 F. 2d 455 (6th Cir. 1970), *cert. denied*, 400 U. S. 999 (1971); *Erling* v. *Powell*, 429 F. 2d 795 (8th Cir. 1970); *City Nat. Bank* v. *Vanderboom*, 422 F. 2d 221 (8th Cir.), *cert. denied*, 399 U. S. 905 (1970); *Iroquois Industries, Inc.* v. *Syracuse China Corp.*, 417 F. 2d 963 (2d Cir. 1969), *cert. denied*, 399 U. S. 909 (1970).

3. Respondents in this case seek both damages and equitable relief by way of rescission of the guaranties and have urged on the basis of cases dispensing with the purchaser-seller requirement in injunction cases (cf. *Mutual Shares Corporation* v. *Genesco, Inc.*, 384 F. 2d 540 (2d Cir. 1967)) that even though not entitled to maintain an action for damages they should be entitled to the equitable relief sought. The Court of Appeals in this case made no such distinction. In *Heyman* v. *Heyman*, 356 F. Supp. 958, 964

> the standing requirement are posited as essentially two fold: first, the purpose of Congress in enacting section 10(b) was merely to extend to sellers of securities the same protection that had been afforded to buyers under the 1933 Securities Act; second, only Congress should change an interpretation of an act unbroken since its passage. *See, e.g.*, Iroquois Industries, Inc. v. Syracuse China Corporation, 417 F. 2d 963 (2d Cir. 1969); Herpich v. Wallace, 430 F. 2d 792 (5th Cir. 1970). . . .
>
> ". . . Were we to extend the provisions of section 10(b) beyond the buyer or seller relationship, we would be judicially extending the terms of the statute and creating new rights. The consequences of the view urged by plaintiffs would establish a new and amorphous body of rights and obligations heretofore unrecognized in federal jurisdiction. Buyer or seller status is indispensable in establishing liability for damages under rule 10b-5." 486 F. 2d 156-57, 158.

Perhaps what is most striking about the opinion of the Seventh Circuit is that it seemingly ignores the basic point relied upon in *Landy* as support for the *Birnbaum* rule, namely, that it was Congress' intent, in enacting § 10(b), "merely to extend to sellers of securities the same protection that had been afforded to buyers under the 1933 Securities Act." Indeed, this has been the primary consideration underlying the purchaser-seller limitation since the decision of *Birnbaum* itself. See 193 F. 2d at 463. Yet apparently without concern for this essential consideration, the Seventh Circuit has abandoned the purchaser-seller limitation and, in doing so, has left an unfilled void in its place. Thus, the Court of Appeals readily acknowledged that it would not "try to formulate a succinct substitute for *Birnbaum*, trusting that the appropriate limits to the rule will best

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(S. D. N. Y. 1973), the court pointed out that the injunction cases have sought to enjoin deceptive practices when resultant loss to stockholders had not yet occurred, and that if *Birnbaum* could be discarded whenever a complaint prayed equitable relief with respect to a consummated transaction the exception would largely "envelop the rule."

be defined through the process of case by case adjudication."[4] (App. I, p. A12 n. 29.) In short, then, the Seventh Circuit not only has seemingly rejected the heretofore recognized significance of Congress' intent in enacting § 10(b) but has also failed to offer any meaningful construction of the standing requirement to replace the structure that has been developed on the basis of that intent in *Birnbaum* and its numerous progeny. Certainly, it is not difficult to imagine the unsettling effect which the Seventh Circuit's decision will have on litigation under § 10(b) and Rule 10b-5.

The Third Circuit's opinion in *Landy* raises the equally important question whether the Seventh Circuit has exceeded the scope of its function of statutory interpretation—as opposed to statutory drafting—in abandoning the purchaser-seller limitation which has long been recognized to be rooted in the intent of Congress. This consideration has clearly been a significant factor in previous decisions concerning the *Birnbaum* rule. Thus, in *Iroquois Industries, Inc.* v. *Syracuse China Corp.*, 417 F. 2d 963 (2d Cir. 1969), *cert. denied*, 399 U. S. 909 (1970), the Court of Appeals for the Second Circuit, although invited by the appellant and the Securities Exchange Commission as amicus curiae to overrule *Birnbaum*, affirmed its original decision there, stating that, in the light of the history set forth in *Birnbaum*, the statute and rule were intended only to extend protection to the "defrauded purchaser or seller." The court then added:

> "The *Birnbaum* rule recognizes the policy of Congress in enacting Section 10(b) and of the Commission in adopting Rule 10b-5, namely, *the protection of defrauded purchasers and sellers*. It is not the province of the courts to

4. Applying such a process to the present case yields only the rather surprising conclusion that if a shareholder of a corporation which purchases or sells a security as a result of alleged fraud or deceit, engages, because of his interest as a shareholder and because of the same fraud or deceit, in a transaction which involves neither the sale nor the purchase of any security, he is entitled to a remedy under the statute and rule to redress any injury alleged to have been sustained.

extend Section 10(b) to apply to transactions not intended to be covered by Congress. We do well to heed the words of Mr. Justice Black, writing for the Court in a case about another section of the 1934 Act, Blau v. Lehman, 368 U. S. 403, 413, 82 S. Ct. 451, 457, 7 L. Ed. 2d 403 (1962):

> " 'Congress can and might amend [the Act] if the Commission would present to it the policy arguments it has presented to us, but we think that Congress is the proper agency to change an interpretation of the Act unbroken since its passage, if the change is to be made.'

"That the conduct averred in any given case may be reprehensible does not mean that a federal remedy must be furnished by judges. . . . If there is to be a federal remedy, it is the Congress which must create it." 417 F. 2d at 969 (emphasis added).

See also Mount Clemens Industries, Inc. v. *Bell,* 464 F. 2d 339, 343 (9th Cir. 1972):

> "Although this language was directed to Section 16(b) of the Exchange Act. . . . we agree with our colleagues of the Second Circuit that it applies with equal force to Section 10(b)."

2. The Decision of the Court of Appeals for the Seventh Circuit Cannot Be Rationalized Under Even the Most Liberal Application That the Birnbaum Doctrine Has Heretofore Been Given.

Substantially all of the Courts of Appeals have, to be sure, recognized that the purchaser-seller limitation is to be read "flexibly." As stated in *Herpich* v. *Wallace,* 430 F. 2d 792, 806 (5th Cir. 1970):

> "We do not say that only those who are purchasers or sellers in the 'strict common law traditional sense' . . . may maintain an action for damages under Rule 10b-5. . . . In deciding whether a plaintiff has standing, we search for what will best establish the congressional purpose . . . Thus we construe the 'in connection with the purchase or

> sale of any security' clause found in both the section and the rule broadly and flexibly to effectuate that purpose. . . . The 'purchaser'—'seller' standing requirement is to be similarly construed . . . so that the broad design of the section and the rule is not frustrated by the use of novel or atypical transactions."

Likewise, *Landy* indicates that while precise guidelines have not been formulated as to when the flexible view of Rule 10b-5 will permit standing in the absence of technical purchaser or seller status, the one criterion generally reiterated is whether standing would effectuate the broad purpose of the rule. See 486 F. 2d at 157. Presumably it was the lack of more precise guidelines to the application of the purchaser-seller limitation that caused the Court of Appeals for the Seventh Circuit to state in this case:

> ". . . Nor does the so-called rule really have integrity when the words 'purchaser' and 'seller' are construed as flexibly as has been necessary in order both to decide 10b-5 cases properly and also to continue to pay homage to the *Birnbaum* rule." (App. I, p. A9.)

Yet contrary to the apparent view of the Court of Appeals, it is clear that the courts applying the flexible interpretation of *Birnbaum* have never lost sight of Congress' basic purpose to extend relief *only* to buyers or sellers of securities in the context of § 10(b) and Rule 10b-5.

In *SEC* v. *National Securities, Inc.*, 393 U. S. 453 (1969), where this Court interpreted § 10(b) and Rule 10b-5 for the first time, it was held that the exchange of shares by shareholders of one company for shares of another company with which their company was merging was a "purchase" of shares within the terms of the statute and the rule. At one point, the Court stated:

> "This case presents none of the complications which may arise in determining who, if anyone, may bring private actions under § 10(b) and Rule 10b-5. Cf. *J. I. Case Co.* v. *Borak*, 377 U. S. 426 (1964). This is a suit brought

> by the Commission; the terms 'purchase' and 'sale' are relevant only to the question of the statutory coverage. Therefore there are no 'standing' problems lurking in the case. . . ." 393 U. S. at 467 n. 9.

Still, confronted with the question "whether the respondents' alleged conduct is the type of fraudulent behavior which was meant to be forbidden by the statute and the rule," the Court explained:

> "According to the amended complaint, Producers' shareholders were misled in various material respects prior to their approval of a merger. The deception furthered a scheme which resulted in their losing their status as shareholders in Producers and becoming shareholders in a new company. Moreover, by voting in favor of the merger, each approving shareholder individually lost any right under Arizona law to obtain an appraisal of his stock and payment for it in cash. Ariz. Rev. Stat. Ann. § 10-347 (1956). Whatever the terms 'purchase' and 'sale' may mean in other contexts, here an alleged deception *has affected individual shareholders' decisions in a way not at all unlike that involved in a typical cash sale or share exchange.* The broad antifraud purposes of the statute and the rule would clearly be furthered by their application to this type of situation. Therefore we conclude that Producers' shareholders 'purchased' shares in the new company by exchanging them for their old stock." 393 U. S. at 467 (emphasis added).

Thus, the rationale employed in *National Securities* was that the shareholders of the old company were "purchasers" of shares within the meaning of § 10(b) and Rule 10b-5 because the alleged deception affected their investment decisions in a way not unlike that involved in an investment decision to purchase or sell securities. Similar reasoning was also applied in *Herpich* v. *Wallace*, 430 F. 2d 792 (5th Cir. 1970), where the court said:

> "In short, Congress meant to afford investors a reasonable opportunity *to make knowing, intelligent decisions regarding their purchases and sales of securities* in un-

> manipulated markets, . . . and the loss resulting in connection with purchases or sales made without benefit of such an opportunity is the type of injury section 10(b) and Rule 10b-5 seek to prevent." 430 F. 2d at 806. (Emphasis added.)

In other words, decisions giving liberal application to the *Birnbaum* doctrine have generally been rationalized on the basis either that the transaction in which the injured party participated had sufficient basic elements of a sale or purchase of the securities involved in the alleged rule violation to bring him within the broad purpose of the rule, or that the injured party had sufficient relation to the transaction in which the purchase or sale of the securities involved in the rule violation occurred to make him a seller or purchaser of such securities within such broad purpose.[5] There is, however, an obvious basic difference between a flexible interpretation of "sale", "purchase", "seller" or "purchaser" which is limited to situations in which the injured party is linked directly to the securities involved in a rule violation, and an interpretation of "any person" upon whom an "act" or "practice" has operated "as a fraud or deceit" "in connection with the purchase or sale of a security" which dispenses altogether with the requirement that such person be either a seller or purchaser—technically or under the flexible view—of the security involved in the rule violation.

This distinction was clearly recognized by the Court of Appeals for the Second Circuit in *International Controls Corp.* v. *Vesco et al.*, ... F. 2d ..... (2d Cir. January 15, 1974, Nos. 73-2202, 73-2255, 73-2568), slip opinion at p. 1399 (Mulligan J. dissenting in part). The majority held that an in-kind dividend of a corporation to its shareholders of the stock

5. Thus, for example, in *National Securities*, the merger was held to have sufficient basic elements of a sale to make the transaction a "sale" of securities in the context of the statute and rule, while in *James* v. *Gerber Products Co.*, 483 F. 2d 944 (6th Cir. 1973), a trust beneficiary was held to be a "seller" of the securities involved in the rule violation because she was the person benefited by the sale and therefore had the interest of a *de facto* seller.

of a wholly owned subsidiary which was induced by fraud was a sale of such stock within the meaning of § 10(b) and Rule 10b-5, even though the corporation received no consideration therefor. While the holding may have extended the flexible concept of "sale" beyond prior decisions, the majority rejected the suggestion of the dissenting Judge that it signalled the demise of *Birnbaum:*

> "Our dissenting brother's 'fear' that our decision today signals the demise of the *Birnbaum* doctrine—limiting standing to sue under § 10(b) to the 'purchaser or seller' of securities—is wholly unfounded. Having determined that ICC's dividend of its Fairfield General portfolio stock was the kind of meaningful disposition of securities which Congress sought to protect under § 10(b), it could not be more clear that ICC was the 'seller' of those securities. Compare *Birnbaum* v. *Newport Steel Corp., supra* (the corporation lacked standing where its controlling shareholder sold *his shares*) with *Ruckle* v. *Roto American Corp., supra* (the corporation had standing where it had agreed to sell its own newly-issued shares)." Slip Op. at p. 1419 n. 16.

Essentially the same distinction between *Birnbaum* and *Ruckle* v. *Roto American Corp.*, 339 F. 2d 24 (2d Cir. 1964), that was put forth in *Vesco* must be said to apply in this case, only in reverse. For if a corporation lacks standing to sue under the rule where its controlling shareholder sold his shares of the corporation, it must follow that shareholders lack personal standing where, as here, the corporation sold its own shares. As the Court of Appeals conceded, the only purchase or sale of a security involved in this case was the transfer of 7,000 shares of stock from Bank Service to Waite Pontiac and respondents could not be characterized as sellers of that stock under the most flexible view of the *Birnbaum* doctrine. Consequently, the court was compelled either to repudiate the *Birnbaum* doctrine or to attempt somehow to extend that doctrine beyond any previous application. In the latter regard, respondents contended both that they were purchasers of securities, by reason that their

guaranty of the indebtedness of Bank Service to GMAC was in effect an agreement to purchase notes evidencing such indebtedness in the event of insolvency, and that they were sellers of securities, by reason of the delivery of such guaranty to GMAC. The guaranty transaction, however, was obviously not an investment transaction by respondents but an ordinary commercial credit transaction not within any purpose of the statute and rule. Cf. *Lino* v. *City Investing Co.*, 487 F. 2d 689 (3d Cir. 1973), and *McClure* v. *First National Bank*, 352 F. Supp. 454 (N. D. Tex. 1973). Therefore, the Court of Appeals chose the only alternative actually available if it was to rule for respondents —it repudiated the *Birnbaum* doctrine completely. It is, then, the continuing viability of that doctrine which is squarely presented to this Court by the decision below.

3. This Court Has Not Heretofore Passed Upon the Correctness of the Birnbaum Doctrine.

While conceding that no holding of this Court is inconsistent with the view that only purchasers or sellers of securities are protected by Rule 10b-5, the Court of Appeals for the Seventh Circuit purported to find support for the rejection of the purchaser-seller requirement in *Superintendent of Ins.* v. *Bankers Life & Casualty Co.*, 404 U. S. 6 (1971). The court's argument is twofold.

First, the Court of Appeals stated that Congress, the Supreme Court, and the Commission have all used the term "investors" to describe the class of persons protected by Rule 10b-5 and the statutory authorization for the rule refers to the prohibition of deceptive devices " 'for the protection of investors.' " It then added: "And speaking for a unanimous court in *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, Justice Douglas stated that the crux of the case was the fact that 'Manhattan suffered injury as a result of deceptive practices touching its sale of securities *as an investor*.' 404 U. S. 6, 12-13 (emphasis

added.)" (App. I, p. A9). By adding emphasis only to the words "as an investor" the Court of Appeals minimized the significance of the preceding language "touching *its sale of securities.*" (Emphasis added.) In fact, this Court in *Bankers Life* also said:

> "Manhattan *was the seller* of Treasury bonds and, it seems to us, clearly protected by § 10(b) . . . of the Securities Exchange Act, which makes it unlawful to use 'in connection with the purchase or sale' of any security, 'any manipulative device or contrivance' in contravention of the rules and regulations of the Securities and Exchange Commission.
>
> "There certainly was an 'act' or 'practice' within the meaning of Rule 10b-5 which operated 'as a fraud or deceit' on Manhattan, the *seller* of the Government bonds." 404 U. S. at 9. (Emphasis added.)

Hence, it appears wholly unreasonable to attach the significance which the Court of Appeals attaches to this Court's usage of the word "investor" in *Bankers Life*.

The Court of Appeals further stated that the "basic holding" of *Birnbaum* was repudiated in *Bankers Life*, and that it was convinced that the purchaser-seller limitation is nothing more than an appendage to that holding without independent justification. (App. I, p. A13.) Four other Courts of Appeal have, however, previously rejected the contention that *Bankers Life* warrants repudiation of the purchaser-seller limitation by implication or otherwise. Thus, for instance, in *Haberman* v. *Murchison*, 468 F. 2d 1305, (2d Cir. 1972), the court, after stating that Section 10(b) and Rule 10b-5 afford protection only to those who actually purchase or sell securities to their loss in reliance upon the withholding or misrepresentation of material information or other manipulative or deceptive devices, said:

> "Nothing in the Supreme Court's opinion in Supt. of Insurance of New York v. Bankers Life and Cas. Co., 404 U. S. 6, 92 S. Ct. 165, 30 L. Ed. 2d 128 (1971), is to the contrary. Although the Court there reversed this court's

> holding that Section 10(b) extended only to fraudulent or manipulative sales and not to the fraudulent appropriation of the proceeds of a sale, it in no way suggested a rejection of the rule that a plaintiff under Section 10(b) *must be a party to the sales transaction.* The Court made clear
>
> > 'that Manhattan [the injured party] was the *seller* of Treasury bonds and, it seems to us, clearly protected by § 10(b) . . . The Act protects corporations as well as individuals who are *sellers* of a security.' 404 U. S. at 9, 10, 92 S. Ct. at 167-168. (Emphasis supplied.)"
>
> 468 F. 2d at 1311 n. 5 (first emphasis added).

See also *Landy* v. *Federal Deposit Insurance Corporation*, 486 F. 2d 139, 155 (3d Cir. 1973), *petition for certiorari filed*, 42 U. S. L. W. 3336 (No. 73-819, November 23, 1973); *James* v. *Gerber Products Co.*, 483 F. 2d 944, 948 (6th Cir. 1973); *Mount Clemens Industries, Inc.* v. *Bell*, 464 F. 2d 339, 344 (9th Cir. 1972). Indeed, it appears clear from this Court's own opinion in *Bankers Life* that the question of the limitations on standing to sue under § 10(b) and Rule 10b-5 was there reserved for future consideration. See 404 U. S. at 13-14 n. 10. Certainly, it cannot be said that the purchaser-seller limitation was rejected in that decision.

4. The Decision of the Court of Appeals for the Seventh Circuit Involves an Important Question of Federal Law Requiring Resolution by This Court.

The purchaser-seller requirement has long been recognized to be an important limitation on the use by private parties of § 10(b) and Rule 10b-5 to seek redress for injury resulting from fraud. The Court of Appeals in this case readily assumed that "complete abandonment of *Birnbaum* will significantly increase our workload," but refused to accept this as a reason for rejecting what it believed "to be a correct interpretation of the statute or the rule." (App. I, p. 12.) Without question, the practical impact of any particular interpretation of a statute is not a rele-

vant consideration in the process of statutory interpretation, the exclusive purpose of which is to determine the intent of Congress in enacting the statute in question. Nevertheless, the practical impact of the interpretation adopted by the Seventh Circuit—that is, the extension of § 10(b) and Rule 10b-5 to apparently large numbers of potential suitors who previously could not invoke the statute or the rule—is certainly a highly relevant consideration in assessing the importance of the decision below. And this consideration is amplified here by the failure of the Court of Appeals, in rejecting *Birnbaum*, to suggest any alternative standards which should govern standing under § 10(b) and Rule 10b-5, thus giving emphasis to the Landy statement that "The consequences of the view urged by plaintiffs would establish a new and amorphous body of rights and obligations heretofore unrecognized in federal jurisdiction." 486 F. 2d at 158.

In sum, an area of such federal significance should not be left in its present unsettled state, particularly not when the position of the Seventh Circuit conflicts with that of every other circuit which has considered the question. The Court of Appeals was, of course, well aware of the disuniformity in federal law which would result from its decision, but it did not believe "that *Birnbaum* should be followed simply to preserve national consistency in the interpretation of federal securities legislation." (App. I, p. 13.) Under such circumstances, as the Court of Appeals further recognized, "the only sure way to achieve consistency throughout the federal judiciary on a question of this character is for the Supreme Court to resolve such conflict among the circuits as does exist." (App. I, p. 13.)

CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for certiorari should be granted.

Respectfully submitted.

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APPENDIX I

IN THE UNITED STATES COURT OF APPEALS
For the Seventh Circuit

September Term, 1973 — September Session, 1973

No. 72-1722

WILLARD D. EASON, M. O. SATROM and JEAN M. SATROM,
Plaintiffs-Appellants,

vs.

GENERAL MOTORS ACCEPTANCE CORPORATION and DAVE WAITE PONTIAC, INC.,
Defendants-Appellees.

Appeal from the United States District Court for the Southern District of Indiana.

No. IP 71 C 613

CALE J. HOLDER,
Judge.

Argued October 19, 1973—Decided December 28, 1973

BEFORE KILEY and STEVENS, *Circuit Judges*, and WYZANSKI, *Senior District Judge.**

STEVENS, *Circuit Judge*. Plaintiffs are shareholders of a corporation which purchased a car leasing business from one of the defendants. In connection with the transaction, the corporate purchaser issued 7,000 shares of its stock to the seller, and the plaintiffs individually guaranteed certain liabilities assumed by the purchaser. Plaintiffs accuse both defendants of

* Senior District Judge Charles Edward Wyzanski, Jr., of the District of Massachusetts, is sitting by designation.

fraud and seek relief under § 10(b) of the Securities Exchange Act of 1934,[1] 48 Stat. 891, 15 USC § 78j(b), and Securities and Exchange Commission Rule 10b-5.[2] The question presented is whether their claim is foreclosed by the so-called *"Birnbaum* rule" which limits private relief for a violation of Rule 10b-5 to persons who were either purchasers or sellers of a security.

The appeal is from an order dismissing plaintiffs' third amended complaint and denying leave to file a fourth. The essential facts are quite simple. Prior to October 31, 1969, one of the defendants (Dave Waite Pontiac, Inc.) operated a Pontiac dealership and also an automatic leasing division. Purchases of cars for the leasing business were financed by General Motors Acceptance Corporation, the second defendant. Bank Service Corporation, a company in which the plaintiffs owned stock, entered into an agreement to purchase the leasing business. As consideration for the business, Bank Service issued 7,000 shares of its stock to Waite and assumed

1. Section 10(b) of the Act provides:

"It shall be unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

2. Rule 10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 CFR § 240.10b-5.

the liabilities of the leasing business, including notes payable to GMAC, and the individual plaintiffs delivered a guarantee of those notes, as well as a guarantee of future liabilities, to GMAC.

The leasing business failed; Bank Service became insolvent and defaulted on the notes.[3] GMAC then brought suit in a state court to recover on the guarantees. Plaintiffs countered with this federal action, accusing both defendants of fraud and seeking rescission of the guarantees.

Plaintiffs seek to avoid *Birnbaum's* purchaser-seller limitation on private relief under Rule 10b-5 in various ways. They contend that their guarantees were securities which they sold to GMAC; that the underlying notes are securities which they are being forced to purchase; that they were indirect sellers of the 7,000 shares of corporate stock; and, in all events, that the *Birnbaum* limitation should be disavowed in this circuit. Since the necessity of stretching the definitions of "purchasers," "sellers," and "securities" is a result of the *Birnbaum* rule, we think it appropriate to examine the viability of that rule first. For purposes of decision, therefore, we assume that the only purchase or sale of a security involved in the transaction was the transfer of 7,000 shares of stock from Bank Service to Waite, and we reject the suggestion that plaintiffs should be characterized as "sellers" of that stock. The question which is thus presented is whether, notwithstanding the fact that they were neither purchasers nor sellers of a security, plaintiffs may obtain relief under Rule 10b-5. In answering that question, we first note that a violation of Rule 10b-5 has been alleged and then consider whether any remedy is available to these plaintiffs.

I.

For present purposes it is conceded that material misstatements and omissions attributable to both GMAC and Waite

3. A subsidiary which operated the business also allegedly became "defunct."

have been adequately alleged. The 7,000 shares of Bank Service stock were unquestionably "securities" within the meaning of Rule 10b-5. It is also settled that the issuance and delivery of such shares constituted a "sale,"[4] and further, that even though the alleged fraud related to the value of the assets acquired, rather than the value of the security delivered, the deception was "in connection with" the sale of a security.[5] Finally, "the fact that the transaction [was] not conducted through a securities exchange or an organized over-the-counter market is irrelevant to the coverage of § 10(b)." *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U. S. 6, 10. In short, defendants do not challenge the conclusion that a violation of Rule 10b-5 has been alleged. Nor would they dispute a federal court's jurisdiction to entertain an appropriate claim by the corporation, Bank Service.[6] The disputed question is whether plaintiffs, as individual shareholders of Bank Service and guarantors of its indebtedness to GMAC, may assert a Rule 10b-5 claim.

II.

The question of plaintiffs' right to relief has three aspects: (a) whether they have "standing," (b) whether they are protected by the rule, and (c) whether overriding considerations of policy should defeat their claim.

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4. See *Dasho* v. *Susquehanna Corp.*, 461 F. 2d 11, 27 (7th Cir. 1972).

5. *Hooper* v. *Mountain States Security Corp.*, 282 F. 2d 195, 201-203 (5th Cir. 1960) *cert, denied* 365 U. S. 814. Not only did the Supreme Court cite *Hooper* with approval in *Superintendent of Insurance* v. *Bankers Life and Casualty Co.*, 404 U. S. 6, 10-11, but the same analysis is applicable to the transaction in the *Bankers Life* case itself. The fraud related to the use of the proceeds of the sale of Manhattan's bonds, rather than the sale of those bonds or even the price at which Manhattan stock was sold to Begole.

6. Presumably such a claim, at least for rescission, would have no value since the 7,000 shares of Bank Service stock which might be recovered are now worthless.

A.

Neither the statute nor Rule 10b-5 expressly authorizes a private remedy. Nevertheless, in a 1946 decision which is now universally followed, Judge Kirkpatrick held that a civil action could be maintained by a member of the class "for whose special benefit the statute was enacted."[7] The *Birnbaum* case, decided six years later,[8] has been read as holding that only the purchaser or the seller of a security may maintain such an action; this purchaser-seller limitation has been frequently described as a "standing requirement."

This "standing requirement" may be interpreted in two quite different ways. On the one hand, it may signify that only purchasers or sellers of securities have legal rights that are protected by Rule 10b-5. In this sense, the analysis of the plaintiff's status—that is to say, his relationship to defendant's violation of Rule 10b-5—really determines whether the plaintiff is a person who has suffered a legal wrong.[9]

On the other hand, as the term "standing" is more properly used, it assumes that the plaintiff is a member of the class protected by the rule at issue, and addresses the question whether he has a sufficient interest in a real controversy with the defendant to entitle him to invoke the jurisdiction of a federal court. Thus, for example, although a taxpayer, in common with the rest of the citizenry, may be protected by the rule he invokes, he may lack standing to litigate an issue because of

7. *Kardon* v. *National Gypsum Co.*, 69 F. Supp. 512, 514 (E. D. Pa. 1946).

8. *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461 (2d Cir. 1952), *cert. denied*, 343 U. S. 956 (A. N. Hand, J.).

9. *Cf.*, Judge Cardozo's classic analysis in *Palsgraf* v. *Long Island Railroad*, 162 N. E. 99, 100 (N. Y. 1928): "What the plaintiff [seeking to sue in tort] must show 'a wrong' to herself, i.e., a violation of her own right, and not merely a wrong to someone else, in conduct 'wrongful' because unsocial, but not 'a wrong' to anyone else."

the "case" or "controversy" limitation on the exercise of federal judicial power. *Frothingham* v. *Mellon*, 262 U. S. 447. In this sense, the requirement that the plaintiff must have "standing" raises a jurisdictional question under Article III of the United States Constitution.[10]

The *Birnbaum* rule has been interpreted as a standing requirement in this constitutional and jurisdictional sense.[11] We are satisfied that such an interpretation of *Birnbaum* is unwarranted and we have no doubt that the plaintiffs' interest in the controversy before us is sufficient to satisfy the requirements of Article III. Indeed, the parties with a vital stake in the outcome of the dispute are the individual plaintiffs on the one hand and GMAC on the other. One or the other will suffer a loss of approximately $300,000—the balance allegedly due on the loans made by GMAC to which plaintiffs' guarantees apply. This dispute may certainly be regarded as a "case" or "controversy" between these parties within the meaning of Article III.

In the *Birnbaum* case itself Judge Hand made no reference to the Constitution and did not mention the word "standing."

10. Professor Wright summarizes the scope of the doctrine as follows:

> "The law of standing is almost exclusively concerned with such public law questions as determinations of constitutionality and review of administrative or other governmental action. In theory, of course, it is not so limited. The person suing for breach of contract or for a tort must satisfy the court that he has standing to bring such a suit, but in practice such suits are brought only by persons harmed by the supposed wrong, and his standing to sue is self-evident. It is only where the question is of a public nature that the interested bystander is likely to attempt suit." C. A. WRIGHT, FEDERAL COURTS, § 13, p. 39 (1970 ed.).

11. See *Herpich* v. *Wallace*, 430 F. 2d 792, 805 (5th Cir. 1970); *Mount Clemens Industries, Inc.* v. *Bell*, 464 F. 2d 339, 343 (9th Cir. 1972). In the latter case the court stated that the purchaser-seller limitation is "required as a matter of constitutional necessity." See, also, *Manor Drug Stores* v. *Blue Chip Stamps*, ... F. 2d .... (9th Cir. Oct. 15, 1973), slip opinion at p. 15 (Hufstedler, J., dissenting).

The decision in that case turned on the court's evaluation of the kind of conduct which was forbidden by Rule 10b-5. The court concluded that the rule was "directed solely at that type of manipulative or fraudulent practice usually associated with the sale or purchase of securities . . ." 193 F. 2d at 464. Since the rule at that time was thought to relate only to public sales of securities, the prohibition of that type of activity was quite reasonably undersood as intended to afford "protection only to the defrauded purchaser or seller." *Ibid.* As conceived by its author, the purchaser-seller limitation was thus a description of the court's understanding of the class of persons protected by Rule 10b-5.

Instead of stating the issue in terms of standing, we think it is more useful to ask whether the plaintiffs were members of the class for whose special benefit Rule 10b-5 was adopted. This is the inquiry which is suggested in Judge Kirkpatrick's opinion which originally articulated the basis for finding an implied private remedy under Rule 10b-5.[12]

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12. Thus, at page 513 of 69 F. Supp. he stated:

> "It is also true that there is no provision in Sec. 10 or elsewhere expressly allowing civil suits by persons injured as a result of violation of Sec. 10 or of the Rule. However, "The violation of a legislative enactment by doing a prohibited act, or by failing to do a required act, makes the actor liable for an invasion of an interest of another if; (a) the intent of the enactment is exclusively or in part to protect an interest of the other as an individual; and (b) the interest invaded is one which the enactment is intended to protect. * * *' Restatements, Torts, Vol. 2, Sec. 286. This rule is more than merely a canon of statutory interpretation. The disregard of the command of a statute is a wrongful act and a tort. As was said in Texas & Pacific R. Co. v. Rigsby, 241 U. S. 33, 39, 36 S. Ct. 482, 484, 60 L. Ed. 874, "This is but an application of the maxim, Ubi jus ibi remedium.' "

And on the following page:

> "The other point presented by the defendants is that, under the general rule of law, civil liability for violation of a statute accrues only to a member of a class (investors) for whose special benefit the statute was enacted—an argument applied to both Sec. 10 and to Rule X-10B-5. Sec. 10 prohibits

B.

Judge Hand's formulation of the "*Birnbaum* rule" in 1952 was an identification of the persons to whom Rule 10b-5 "extended protection." Protection against the type of fraudulent practice usually associated with the sale or purchase of securities appropriately extended "only to the defrauded purchaser or seller." In the last two decades, however, the rule has been interpreted to encompass additional types of misconduct and to extend protection to a variety of persons not included within the traditional definition of either purchaser or seller. Thus, issuers,[13] trust beneficiaries,[14] merging corporations,[15] minority shareholders in short form mergers,[16] parties to incomplete transactions,[17] offerees,[18] and others[19] have been treated as though they were sellers and thereby accorded the protection of the rule. The course of judicial decision since 1952, when *Birnbaum* was decided, has actually recognized that the class of protected persons is broader than merely purchasers and sellers.

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deceptive devices 'in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.' I cannot agree, however, that 'investors' is limited to persons who are about to invest in a security or that two men who have acquired ownership of the stock of a corporation are not investors merely because they own half of the total issue."

13. *Hooper* v. *Mountain States Security Corp.*, *supra.*

14. *James* v. *Gerber Products Co.*, 483 F. 2d 944 (6th Cir. 1973).

15. *Dasho* v. *Susquehanna Corp.*, 380 F. 2d 262, 267 (7th Cir. 1967), (Fairchild, J., concurring), *cert. denied Bard* v. *Dasho*, 389 U. S. 977; see also *Dasho* v. *Susquehanna Corp.*, 461 F. 2d 11, *supra.*

16. *Vine* v. *Beneficial Finance Co.*, 374 F. 2d 627 (2d Cir. 1967), *cert. denied* 389 U. S. 970.

17. *A. I. Brod & Co.* v. *Perlow*, 375 F. 2d 393 (2d Cir. 1967).

18. *Manor Drug Stores* v. *Blue Clip Stamps*, *supra.*

19. See generally A. R. Bromberg, SECURITIES LAW: FRAUD SEC. RULE 10b-5, § 8.8 (1971).

The language of Rule 10b-5 itself describes any act or practice which operates as a fraud or deceit "upon any person in connection with the purchase or sale of a security." The Supreme Court has repeatedly stated that this language should be given a broad and flexible construction.[20] Construing the words "any person" to include a purchaser or a seller but no one else is not consistent with that admonition. Nor does the so-called rule really have integrity when the words "purchaser" and "seller" are construed as flexibly as has been necessary in order both to decide 10b-5 cases properly and also to continue to pay homage to the *Birnbaum* rule. Moreover, a formal purchaser-seller limitation is not consistent with the overriding requirement that, in construing the 1934 Act, "form should be disregarded for substance and the emphasis should be on economic reality." *Tcherepnin* v. *Knight*, 389 U. S. 332, 336.

Congress, the Supreme Court, and the Commission have all used the term "investors" to describe the class of persons protected by Rule 10b-5. Thus, the statutory authorization for the rule refers to the prohibition of deceptive devices "for the protection of investors."[21] And speaking for a unanimous court in *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, Justice Douglas stated that the crux of the case was the fact that "Manhattan suffered injury as a result of deceptive practices touching its sale of securities *as an investor*." 404 U. S. 6, 12-13 (emphasis added).[22]

In its brief as amicus curiae in that case, the Securities and Exchange Commission also stressed the statutory purpose, implemented by Rule 10b-5, to protect investors from all forms

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20. See, e.g., *Affiliated Ute Citizens* v. *United States*, 406 U. S. 128, 151.

21. See § 10(b) quoted in footnote 1, *supra*.

22. Earlier in the opinion Justice Douglas stated that Manhattan "was injured as an investor through a deceptive device. . . ." 404 U. S. at 10.

of securities fraud.[23] Instead of attaching significance to the fact that Manhattan was the seller of the government securities, the Commission stated: "Manhattan not only suffered an injury as a result of the fraudulent dealings in its government securities, it suffered that injury in its capacity as an investor."[24]

Although no Supreme Court holding is inconsistent with the view that only purchasers or sellers of securities are protected by Rule 10b-5, we thing the Court's opinions fairly imply that the rule was intended to protect a broader class of persons. The emphasis on the injured party's status as an investor indicates that the protection of the rule extends to persons who, in their capacity as investors, suffer significant injury as a direct consequence of fraud in connection with a securities transaction, even though their participation in the transaction did not involve either the purchase or the sale of a security.

The plaintiffs in this case were certainly "investors" in the transaction which is allegedly tainted by fraud. Their interest as stockholders of Bank Service Corporation was apparently sufficient to induce them to execute substantial personal guarantees. As individual guarantors they were direct parties to the transaction in dispute. If, as plaintiffs have alleged, the transaction was consummated in violation of Rule 10b-5, we believe the plaintiffs, as investors and as principals in the transaction, suffered a legal injury which may be redressed by a federal court.

C.

In addition to suggesting that the *Birnbaum* rule is constitutionally compelled, it has been argued that the purchaser-seller

23. "While Congress had no purpose to regulate transactions which comprise no more than internal corporate mismanagement, it sought to protect securities investors, including corporations such as Manhattan, from all forms of securities fraud." Brief for the Securities and Exchange Commission at p. 23.

24. *Id.* at 29.

limitation should be retained to forestall an unmanageable flood of federal litigation,[25] and to preserve national consistency in the interpretation of federal securities legislation.[26] We find neither of these arguments persuasive.

The volume of 10b-5 litigation has already expanded dramatically and will no doubt continue to do so whether or not the purchaser-seller limitation is rejected.[27] The extent to which a refusal to adhere to *Birnbaum* will affect that volume is really a matter of speculation.[28] The fact that the purchaser-seller limitation is unacceptable does not mean that there will be no

25. See, *e.g.*, Judge Hufstedler's dissent in *Manor Drug Stores* v. *Blue Chip Stamps*, ... F. 2d. .... (9th Cir. Oct. 15, 1973), slip opinion at p. 15.

26. See *Mount Clemens Industries, Inc.* v. *Bell*, *supra*, 464 F. 2d at 342.

27. As Judge Wisdom has noted:

> "In recent years, the rule has been applied in such a variety of situations that one can scarcely find an issue of the advance sheets of the Federal Supplement and Federal Reporter that does not contain an opinion on § 10(b). This extraordinary expansion of subject-matter coverage by § 10(b) and Rule 10b-5, coupled with the possibility of extraordinarily great liability, has moved courts to limit the class of persons who may recover to purchasers or sellers of securities." *Rekant* v. *Desser*, 425 F. 2d 872, 877 (5th Cir. 1970).

28. It is not unlikely that the principal cause of concern about the increase in this type of litigation is an assumption that it will always be much easier to allege and prove a 10b-5 case than a common law fraud case. That assumption may not be warranted because it is not necessarily true that the strict standards of disclosure which appropriately apply to transactions in which there is a dramatic disparity in the parties' access to material information will automatically and totally apply to negotiated transactions in which the parties typically rely on contract warranties and pre-closing inspections or audits as a basis for the investment decision. A flexible statute which emphasizes the relevance of the context in which a transaction takes place should neither limit its protection to an arbitrarily defined class of purchasers and sellers, nor arbitrarily assume that every purchaser and every seller is entitled to precisely the same disclosure. See Comment, *The Prospects for Rule X-10B-5; An Emerging Remedy for Defrauded Investors*, 59 YALE L. J. 1120, 1143 (1950).

limit of any kind on the availability of private relief.[29] For in each case the plaintiff will have to demonstrate membership in the "special class" protected by Rule 10b-5 and injury as a direct consequence of the alleged violation. The number of parties who may invoke Rule 10b-5 without the purchaser-seller limitation may not differ materially from the number who would recover by persuading a court to interpret the purchaser-seller concept flexibly.

Assuming, however, that a complete abandonment of *Birnbaum* will significantly increase our workload, we may not for that reason reject what we believe to be a correct interpretation of the statute or the rule. Indeed, the volume of future litigation that was more clearly predictable as a consequence of the Supreme Court's holding in the *Bankers Life* case was not even mentioned in the Court's opinion as a possible objection to its broadened interpretation of Rule 10b-5 as encompassing the misuse of proceeds of sale. The fear that the volume of 10b-5 litigation may actually impair the effective operation of organized securities markets, see *Herpich* v. *Wallace*, *supra*, 430 F. 2d at 804, is not, in our opinion, well founded; but if we are wrong, the Securities and Exchange Commission has both the power and the expertise to adopt appropriate amendments to

29. Section 4 of the Clayton Act expressly authorizes "any person injured in his business or property by reason of" an antitrust violation to sue for damages. Although that broad language opened "nearly limitless possibilities" for damage recovery, a case by case evaluation of what may be described either as the "standing" issue or the concept of injury has resulted in a significant limitation on the potential scope of recovery. See generally *In re Multidistrict Vehicle Air Pollution M. D. L. No. 31*, 481 F. 2d 122 (9th Cir. 1973), and the many cases cited therein. We question whether the rejection of the purchaser-seller limitation in Rule 10b-5 litigation will have any more disastrous consequence than the rejection of any one of the "talismanic rubrics'" identified in that opinion. Either a "target area" or a "direct injury" analysis would seem preferable to a somewhat tattered purchaser-seller rubric. In any event, we deliberately avoid the temptation to try to formulate a succinct substitute for *Birnbaum*, trusting that the appropriate limits to the rule will best be defined through the process of case by case adjudication.

the rule. As the Commission has repeatedly stated, it is now of the view that the purchaser-seller limitation is an artificial restriction inconsistent with the intent of the underlying statute. That view merits our respect.

Nor do we believe that *Birnbaum* should be followed simply to preserve national consistency in the interpretation of federal securities legislation. We are inclined to think that the extent of the consistency in applying *Birnbaum* is overstated[30] and is less important than an independent appraisal of an important issue arising in an area of the law which, despite the age of the statute, is still in an embryonic stage of development. See *Dasho* v. *Susquehanna Corp., supra*, 461 F. 2d 11, 23 at n. 26. In all events, the only sure way to achieve consistency throughout the federal judiciary on a question of this character is for the Supreme Court to resolve such conflict among the circuits as does exist.

As Judge Sprecher demonstrated in *Jannes* v. *Microwave Communications, Inc.*, 461 F. 2d 525, 528-530 (7th Cir. 1972), the basic holding of *Birnbaum* was repudiated by a unanimous Supreme Court in the *Bankers Life* case. We are convinced that the purchaser-seller limitation is nothing more than an appendage to that holding without independent justification. We hold that it is not part of the law of this circuit.[31]

The judgment is reversed and the case is remanded for further proceedings.

30. Bromberg has noted that "the buyer condition has been stretched by broad interpretation to include almost any shareholder affected by a corporate transaction." Bromberg, Securities Law, Vol. 2, § 8.8, p. 222. We also note that our decision in *Dasho* v. *Susquehanna Corp.*, 380 F. 2d 262, *supra*, is frequently cited for the proposition that *Birnbaum* is the law of this circuit. In *Dasho*, however, Judge Fairchild merely explained why the *Birnbaum* formulation would not defeat plaintiff's claim, since merging corporations are both sellers and purchasers of securities. *Id.* at 269-270, cited with approval in *Securities and Exchange Commission* v. *National Securities, Inc.* 393 U. S. 453, 467-468.

31. This opinion has been circulated to all judges in regular active service; no judge has requested that the case be reheard *en banc*.

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

December 28, 1973

Before

HON. ROGER J. KILEY, *Circuit Judge*
HON. JOHN PAUL STEVENS, *Circuit Judge*
Hon. CHARLES EDWARD WYZANSKI, JR., *Senior District Judge**

WILLARD D. EASON, M. O. SATROM and JEAN M. SATROM,
Plaintiffs-Appellants,

No. 72-1722 *vs.*

GENERAL MOTORS ACCEPTANCE CORPORATION and DAVE WAITE PONTIAC, INC.,
Defendants-Appellees.

Appeal from the United States District Court for the Southern District of Indiana.

JUDGMENT.

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Indiana, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, REVERSED, with costs, and the cause be and the same is hereby REMANDED to the said District Court, in accordance with the opinion of this Court filed this day.

* Senior District Judge Charles Edward Wyzanski, Jr., of the District of Massachusetts, is sitting by designation.

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

January 23, 1974

Before

HON. ROGER J. KILEY, SR., *Circuit Judge*
HON. JOHN PAUL STEVENS, *Circuit Judge*
HON. CHARLES E. WYZANSKI, SR., *District Judge*

WILLARD D. EASON, M. O. SATROM and JEAN M. SATROM,
Plaintiffs-Appellants,

No. 72-1722 *vs.*

GENERAL MOTORS ACCEPTANCE CORPORATION and DAVE WAITE PONTIAC, INC.,
Defendants-Appellees.

Appeal from the United States District Court for the Southern District of Indiana, Indianapolis Division.

(IP 71 C 613)

On consideration of the petition for rehearing and suggestion that it be reheard *en banc* filed in the above-entitled cause, no Judge in active service having requested a vote thereon, nor any Judge having voted to grant the suggestion, and all of the members of the panel having voted to deny a rehearing.

IT IS ORDERED that the petition for a rehearing in the above-entitled cause be and the same is hereby DENIED.

APPENDIX II

UNITED STATES DISTRICT COURT
Southern District of Indiana
Indianapolis Division

WILLARD E. EASON, M. O. SATROM and JEAN M. SATROM

vs.

GENERAL MOTORS ACCEPTANCE CORP., DAVE WAITE PONTIAC, INC.

No. IP 71-C-613

Entry for June 20, 1972

HONORABLE CALE J. HOLDER, *Judge*

This cause came before the Court upon the defendant General Motors Acceptance Corporation's motion to dismiss the third amended complaint and each paragraph thereof and the Court being duly advised in the premises now SUSTAINS the motion to dismiss and the action is dismissed as to G. M. A. C. The plaintiffs have no standing to maintain the action against G. M. A. C. under Section 10(b) of Securities Exchange Act of Rule 10(b)5 promulgated thereunder. (*Brinbaum* v. *Newport Steel Corporation*, 2 Circuit, 193 F. 2d 461; and *Jachimiec, etc.* v. *Schenley Industries, Inc.*, 7 Circuit (Feb. 26, 1965) Cause No. 15027.

(C. R. No. 1, p. 25-A.)

UNITED STATES DISTRICT COURT
Southern District of Indiana
Indianapolis Division

WILLARD D. EASON, et al.

vs.

GENERAL MOTORS ACCEPTANCE CORPORATION, and DAVE WAITE PONTIAC, INC.

No. IP 71-C-613

Entry for June 20, 1972

HONORABLE CALE J. HOLDER, *Judge*

This cause came before the Court on the plaintiffs' motion for leave to file fourth amended complaint and for an extension of time to file a notice of appeal. The Court, after considering said motion and being duly advised in the premises, now denies the same.

This cause also came before the Court on the plaintiffs' motion for default. The Court, after considering said motion and being duly advised in the premises, now denies the same.

This cause also came before the Court on the motion of Defendant Waite to dismiss plaintiffs' third amended complaint as to Dave Waite Pontiac, Inc. The Court, after considering said motion and being duly advised in the premises, now SUSTAINS the same, and the action is dismissed without prejudice with costs assessed against plaintiffs.

This cause also came before the Court on the objections of Defendant General Motors Acceptance Corporation to filing of fourth amended complaint. The Court, after considering said objections and being duly advised in the premises, now sustains the same, and the action is dismissed without prejudice with costs assessed against plaintiffs.

(C. R. No. 1, p. 29-A.)

SUPREME COURT, U. S.
MAR 27 19
MICHAEL RODAK, JR.

IN THE

Supreme Court of The United States

OCTOBER TERM, 1973

No. 73-1323

GENERAL MOTORS ACCEPTANCE CORPORATION and DAVE WAITE PONTIAC, INC.,

Petitioners,

vs.

WILLARD D. EASON, M. O. SATROM and JEAN M. SATROM, individually and as representatives of BANK SERVICE CORPORATION, GENERAL AUTO LEASING AND RENTAL CORPORATION,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1323

GENERAL MOTORS ACCEPTANCE CORPORATION and DAVE WAITE PONTIAC, INC.,

Petitioners,

vs.

WILLARD D. EASON, M. O. SATROM and JEAN M. SATROM, individually and as representatives of BANK SERVICE CORPORATION, GENERAL AUTO LEASING AND RENTAL CORPORATION,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

QUESTIONS PRESENTED

The appeal to the Court of Appeals for the Seventh Circuit was from an order dismissing respondents' complaint alleging 10b-5[1] claims against petitioners on behalf

[1] 17 C.F.R. §240.10b-5, ("Rule 10b-5") promulgated by the Securities Exchange Commission under §10(b) ("§10 (b)") of the Securities Exchange Act of 1934 (15 U.S.C. 78) (the "Act")

of respondents ("Eason and Satrom") individually and as representatives of Bank Service Corporation ("Bank Service")[2] and its subsidiary. As part of the transaction involving the issuance of 7,000 shares of the common stock of Bank Service in exchange for the purchase of the business of Waite Leasing from Waite Pontiac, respondents executed two continuing guaranties (the "Guaranty") covering certain existing and future long-term notes (the "Notes"). There was alleged fraud, and thus a violation of Rule 10b-5, in connection with that transaction. Eason and Satrom, who are being sued in state court by GMAC on the Guaranty for the amounts remaining to be paid under the Notes, have suffered alleged damages of at least $500,000.00 as a result of the fraud. Thus, in addition to the one question set forth by petitioners (Petition at 2), the following questions also would have to be considered upon a review of this case:

1. Is the Guaranty, which is a promise to pay and therefore has the same attributes as a note, a "security"?

2. Can Eason and Satrom be liable under certain "securities" (the Notes) and at the same time be denied the right to assert the 10b-5 violation that prompted the transaction which contractually created that alleged liability? In effect, are Eason and Satrom "purchasers" of the Notes?

3. Were Eason and Satrom indirect sellers of the 7,000 shares of Bank Service stock or forced sellers of their own stock of Bank Service which is now insolvent and defunct?

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[2] The following additional terms utilized by petitioners will also be utilized in this brief: "GMAC", "Waite Pontiac" and "Waite Leasing". The appendices to the Petition setting forth the opinions below will be referred to as "App. I" and "App. II".

4. Are Eason and Satrom entitled to maintain a 10b-5 derivative action on behalf of Bank Service which was defrauded and deceived in connection with the sale of its securities?

These additional questions were not considered in the opinion below because, in arriving at its result, the court chose a path that circumvented the need to meet any of these questions. Reversal of the opinion would require a negative response to each of them.

STATEMENT OF THE CASE

There was but one transaction on which respondents' 10b-5 action is predicated. As shareholders of Bank Service, Eason and Satrom were induced to execute the agreement pursuant to which Bank Service purchased the business of Waite Leasing in exchange for 7,000 shares of Bank Service stock and, concurrently, to execute and issue the Guaranty which was purchased by GMAC as a condition precedent to GMAC's investment in the Notes.

As concluded in the opinion below, respondents were investors in and direct parties to the transaction in dispute. As alleged, the transaction was tainted by fraud in violation of Rule 10b-5. As investors and principals in the transaction, Eason and Satrom have suffered legal injury. (App. I at A 10)

The District Court for the Southern District of Indiana dismissed respondents' complaint, citing *Birnbaum v. Newport Steel Corp.*, 193 F. 2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S 956 (1952). (App. II at A 16) In *Birnbaum*, Judge Hand judicially imposed two limitations with regard to §10(b) and Rule 10b-5. The first limitation was:

> "... that section [§10(b)] was directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs, ..." (193 F. 2d at 464)

In the same sentence, Judge Hand added the second limitation that Rule 10b-5 "extended protection only to the defrauded purchaser or seller." Based on this Court's decision in *Superintendent of Insurance of the State of New York v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971), the primary holding in *Birnbaum* has no remaining viability. The District Court apparently concluded, however, that the purchaser-seller limitation survived *Bankers Life* and that respondents were neither purchasers nor sellers of any security.

In the opinion below, the Court of Appeals first framed the question presented as whether respondents' "claim is foreclosed by the so-called '*Birnbaum* rule' which limits private relief for a violation of Rule 10b-5 to persons who were either purchasers or sellers of a security." (App. I at A 2) The court, however, elected to bypass the above questions relating to whether respondents were purchasers or sellers of securities in order to examine the remaining viability of that *Birnbaum* rule. For purposes of its decision, the court therefore *assumed* "that the only purchase or sale of a security involved in the transaction was the transfer of 7,000 shares of stock from Bank Service to Waite [Pontiac]" and thereby refined the question presented as being "whether, notwithstanding the fact that they were neither purchasers nor sellers of a security, [respondents] may obtain relief under Rule 10b-5." (App. I at A 3) That phrasing of the question is the one adopted by petitioners. (Petition at 2)

The court, however, further refined the question presented to "whether [Eason and Satrom], as individual shareholders of Bank Service and guarantors of its indebtedness to GMAC, may assert to Rule 10b-5 claim." (App. I at A 4)

While petitioners are technically accurate in stating that "[t]he Court of Appeals for the Seventh Circuit did not disagree with the District Court's conclusion that respondents were neither purchasers nor sellers of securities . . . ."(Pettition at 5), any attempt to negatively imply that the Court of Appeals agreed with that conclusion is totally inaccurate. The negative implication is without justification because the Court of Appeals disagreed with the District court's conclusion that the *Birnbaum* purchaser-seller limitation had any independent justification after this Court in *Bankers Life* unanimously repudiated the basic holding in *Birnbaum*. Without considering any questions relating to whether Eason and Satrom were purchasers or sellers of a security, the Court of Appeals made an independent appraisal with regard to whether Eason and Satrom were included within the class of persons protected by Rule 10b-5.

REASONS WHY THE CAUSE SHOULD NOT BE REVIEWED BY THIS COURT

1. The Decision Below is Not in Conflict with the Decisions of Other Courts of Appeals.

Petitioners' first two reasons for granting review are intended to show that the decision in this case conflicts with the decisions of other Courts of Appeals on the same matter. The two arguments will be considered together and must be considered in the framework of the question presented, as phrased by petitioners. That question is

its were neither pur-
"whether, notwithstanding respondenney may nevertheless
chasers nor sellers of any security, th0(b) of the Act and
maintain a private action" under §1(
Rule 10b-5. (Petition at 2)

inion below conflicts

Petitioners first argue that the opn *Birnbaum*. In their
with every other circuit's decision orrs recognize that all
second argument, however, petitioneach to the purchaser-
of the circuits take a flexible approacontend that none of
seller limitation; nevertheless, they iberal as the Seventh
the Courts of Appeals has been as li
Circuit.

arguments contradict

Thus, petitioners' first and second es petitioners to rela-
one another. Existing case law forceof absolutes, and the
tivize rather than argue in terms o of degree. The first
alleged conflict thus changes to oneon. The second agru-
argument suggests a head-on collisiand goes further than
ment, that this case simply passes a first argument and
its predecessors, repudiates the ent—persons who are
answers the question petitioners pres securities have been
neither purchasers nor sellers of some time.
allowed to maintain 10b-5 actions for s ency suggests, when

As petitioners' logical inconsiste disregarded and the
references of fealty to *Birnbaum* are nalyzed, any asserted
facts and results of the cases are als alone. With regard
conflict can be seen as one of wordr limitation, Judge
to the *Birnbaum* purchaser-selle historical growth of
Stevens accurately summarized the 0b-5 protection:
the class of persons who could claim 1ver, the rule has been

> "In the last two decades, howe ional types of miscon-
> interpreted to encompass additi o a variety of persons
> duct and to extend protection t al definition of either
> not included within the tradition uers,[13] trust benefici-
> purchaser or seller. Thus, iss

> aries,[14] merging corporations,[15] minority shareholders in short form mergers,[16] parties to incomplete transactions,[17] offerees,[18] and others[19] have been treated as though they were sellers and thereby accorded the protection of the rule. The course of judicial decision since 1952, when *Birnbaum* was decided, *has actually recognized that the class of protected persons is broader than merely purchasers and sellers.*" (App. I at A 8)[3]

Petitioners state the Second, Third, Fifth, Sixth, Eighth and Ninth circuits—allegedly the only other circuits which have considered the *Birnbaum* rule—oppose the decision in this case. But, as the above quote from Judge Stevens' opinion sets forth by way of examples, 10b-5 protection has been extended to persons who were neither purchasers nor sellers of securities: by the Second Circuit in *Vine v. Beneficial Finance Co.*, 374 F. 2d 627 (2d Cir. 1967), *cert. denied*, 389 U.S. 970 (1967) and in *A. T. Brod & Co. v. Perlow*, 375 F. 2d 393 (2d Cir. 1967); by the Fifth Circuit in *Hooper v. Mountain States Securities Corp.*, 282 F. 2d 195 (5th Cir., 1960), *cert. denied*, 365 U.S. 814 (1961); by the Sixth Circuit in *James v. Gerber Products Co.*, 483 F. 2d 944 (6th Cir. 1973); by the Seventh Circuit in *Dasho v. Susquehanna Corp.*, 380 F. 2d 262, 267 (7th Cir. 1967), (Fairchild, J., concurring), *cert denied, sub. nom. Bard v. Dasho*, 389 U.S. 977 (1967); and by the Ninth Circuit in *Manor Drug Stores v. Blue Chip Stamps*, —— F. 2d ——, No. 71-2223, (9th Cir. October 15, 1973) (hearing *en banc* pending).

Vine is one of several "forced seller" cases, a doctrine that the Second and Fifth Circuits extended further in

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[3] All emphasis is added unless otherwise specified. Footnote 19 of the court refers generally to A.R. Bromberg, Securities Law: Fraud Sec. Rule 10b-5, §8.8(1971). The other footnote references of the court are identified in the next paragraph of this brief.

Crane Co. v. Westinghouse Airbrake Co., 419 F. 2d 787 (2d Cir. 1969), *cert. denied*, 400 U.S. 822 (1970) and *Dudley v. Southeastern Factor & Finance Corp.*, 446 F. 2d 303 (5th Cir. 1971), *cert. denied*, 404 U.S. 858 (1971). In *Dudley*, plaintiff claimed that the corporation for which he was a receiver had not received assets which it should have received as a shareholder upon the liquidation of another corporation. The court held that plaintiff's corporation was a "seller" when its investment changed from an equity in a going enterprise to a claim.

A. T. Brod involved a customer-broker transaction with the customer refusing to pay for stock after the price fell. Other cases involving incompleted transactions, and thus no purchaser or seller of securities, are *Opper v. Hancock Securities Corp.*, 367 F. 2d 157 (2d Cir. 1966), *aff'g.* 250 F. Supp. 668 (S.D.N.Y. 1966); *Goodman v. H. Hentz & Co.*, 265 F. Supp 440 (N.D. Ill. 1967); and *Stockwell v. Reynolds & Co.*, 252 F. Supp. 215 (S.D.N.Y. 1965). These cases are sometimes characterized as enunciating the "aborted purchaser-seller doctrine."

The Ninth Circuit was presented with a non-transaction in *Mount Clemens Industries, Inc. v. Bell*, 464 F. 2d 339 (9th Cir. 1972). This is the only Ninth Circuit case cited by petitioners despite two more recent decisions, and even it does not help petitioners with regard to the question they present.

The plaintiff in *Mount Clemens* alleged that it had failed to purchase all of the issued stock of Missile Dynamics Corporation at a sheriff's sale because of defendant's misrepresentations. Plaintiff obviously was not a purchaser or a seller of a security. If the Ninth Circuit had considered that the question presented by petitioners to this Court was determinative, the court could have stopped there. The

Ninth Circuit recognized, however, that the two decades of case law following *Birnbaum* precluded it from doing so:

> "These allegations clearly reveal that appellants never actually purchased or sold the Missile Stock. Yet that circumstance does not end our inquiry, for under the liberal interpretation that has sometimes attended the application of the *Birnbaum* doctrine, *there have been cases in which standing has been afforded to persons who, even though not actual purchasers or sellers, have been deemed to have the required status.*" (464 F. 2d at 345)

The court proceeded to recognize and discuss the cases enunciating the "aborted purchaser-seller doctrine" but distinguished the facts in *Mount Clemens* based upon the "lack of a prior contractual relationship." (464 F. 2d at 346) Since *Mount Clemens*, the Ninth Circuit has decided *Walling v. Beverly Enterprises*, 476 F. 2d 393. (9th Cir. 1973); and *Manor Drug Stores v. Blue Chip Stamps, supra.*

In *Walling*, plaintiffs alleged that the defendant had entered into a contract to purchase their securities without fully intending to perform under the contract. The court recognized at the outset the dictates of *Bankers Life.* The contractual relationship that was missing in *Mount Clemens* was present in *Walling.* The court reversed the trial court's dismissal of the complaint.

In *Manor Drug*, plaintiffs charged they failed to purchase securities because an offering prospectus was misleading. The offering was made pursuant to an antitrust consent decree. Plaintiffs were not parties to the decree and could not have directly enforced the decree. Despite the absence of a "contractual relationship" the court, switching to more of a causational approach, held that

the plaintiffs were entitled to maintain their 10b-5 action. In referring to causation, the court distinguished *Mount Clemens* on the basis that an informed decision by the offerees in *Manor Drug* "could not have been thwarted by the intervention of an earlier or higher bidder" as in *Mount Clemens.* (slip opinion, n. 15)

Causation as a means of harmonizing the results in various 10b-5 cases was suggested by Judge Wisdom in *Rekant v. Dresser,* 425 F. 2d 872 (5th Cir. 1970):

> "The cases professedly disallowing a federal action under §10(b) and Rule 10b-5 for corporate mismanagement may perhaps be distinguished on the issue of causation. In *Birnbaum,* the corporation was not a direct party to the allegedly fraudulent transaction; the president of Newport Steel, in his official capacity, rejected a merger proposal from Follansbee Steel, and instead personally sold his control block of Newport stock to Follansbee at a substantial profit. Similarly in the private damage cases, such as Mutual Shares Corp. v. Genesco, Inc., 2 Cir. 1967, 384 F. 2d 540, there was no direct dealing between the plaintiff and the perpetrator of the alleged fraudulent stock transaction. The hesitancy of courts to grant a cause of action under Rule 10b-5 when the causal connection between the fraud and the injury is not readily apparent, as when there is no direct dealing between the parties, may explain in part, at least, the diverse results." (425 F. 2d at 881)

When the analysis is titled "causation", the court is speaking after the fact. Other courts have stepped back and emphasized the *probability* of causation. Judge Cardozo spoke of persons within the "risk reasonably to be perceived."[4] Judge Stevens focused on the "class for

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[4] *Palsgraf v. Long Island R. Co.,* 248 N.Y. 339, 162 N.E. 99, 100 (1928)

whose special benefit'' 10b-5 was adopted. (App. I at A 7) Judge Ely talked of persons within the ''target area''.[5] In each case the *relation* of the plaintiff to the defendant, not the *title* of either party, is the important element.

Thus, *Landy v. Federal Deposit Insurance Corp.*, 486 F. 2d 139 (3rd Cir. 1973), *petition for cert. filed*, 42 U.S. L.W. 3336 (U.S. November 23, 1973) (No. 73-819) does not put the Third Circuit in conflict with the Seventh. *Landy* involved a bank officer speculating in the market with bank funds. The 10b-5 ''standing'' portion of the decision concerns shareholders who neither bought, sold nor acted in any way. There were no misrepresentations alleged. Based on the *relationship* between the parties, or more appropriately the lack thereof, the result in *Landy* was correct without any reference to *titles* or to *Birnbaum*. *Landy*, with non-action and non-disclosure, has no factual similarity to cases, such as this case, that allege the plaintiff acted in response to misrepresentations and direct dealings involving non-disclosures. Further, the Third Circuit is also the home of *Kahan v. Rosenstiel*, 424 F. 2d 161 (3rd Cir. 1970), *cert. denied*, 398 U.S. 950 (1970). *Kahan* was one of the first major opinions to suggest the causal analysis later articulated from a different angle in the opinion below:

> ''Neither the language of §10(b) and Rule 10b-5 nor the policy they were designed to effectuate mandate adherence to a strict purchaser-seller requirement so as to preclude suits for relief if a plaintiff can establish a causal connection between the violations alleged and plaintiff's loss.'' (429 F. 2d at 798)

Similar to *Landy*, *Simmons v. Wolfson*, 428 F. 2d 455 (6th Cir. 1970), *cert. denied*, 400 U.S. 999 (1971) and

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[5] *In Re Multidistrict Vehicle Air Pollution, M.D.L. No. 31*, 481 F. 2d 122, 127 (9th Cir. 1973)

Erling v. Powell, 429 F. 2d 795 (8th Cir. 1970) involved non-acting shareholders and non-disclosing corporate insiders. These decisions do not place either the Sixth or the Eighth Circuit in conflict with the Seventh. The relevance of *Simmons* is further decreased by the later Sixth Circuit case, *James v. Gerber Products Co.,* cited in the opinion below, *supra,* n. 3. In *James,* the beneficiary of a trust was allowed to bring a 10b-5 action for a sale by the trustee to Gerber. After allowing an admitted non-seller to bring the action, the court gave *Birnbaum* the following dubious reference:

> "We conclude that the interests intended to be served by Rule 10b-5 and the *Birnbaum* decision are best promoted by providing standing to the appellant. Because of the nature of our holding, we do not find it necessary to reach the question of *Birnbaum's* continued viability in this Circuit." (483 F. 2d at 948)

Apart from the factual inapplicability, any surface adherence to *Birnbaum* in *Erling* is negated by the Eighth Circuit's causal approach. First it quoted approvingly the causal approach of *Kahan* quoted above and then phrased its own standard in comparable terms:

> "Similarly, Erling demonstrates no basis for qualifying for standing as a Rule 10 (b)-5 plaintiff under relaxed standards *which permit plaintiffs* who are not buyers or sellers of securities in a technical sense *to sue upon showing damages flowing from misrepresentation, deception or market manipulations by a buyer or seller of securities.*" (429 F. 2d at 799)

That leaves the Tenth Circuit. Petitioners imply the Tenth Circuit has not considered the question. (Petition at 6, n. 2) They overlook *Vincent v. Moench,* 473 F. 2d 430 (10th Cir. 1973). The Tenth Circuit position is succinctly stated:

> "From our point of view, and with the benefit of this trend, we think Section 10 (b)'s language outlawing deception or manipulation 'in connection with the purchase or sale of any security' must be construed as meaning that in a suit for equitable relief any person showing a 'causal connection' between the fraudulent sale of a security and injury to himself may invoke federal jurisdiction." (473 F. 2d at 434-35)

As in this case, the equitable relief sought in *Vincent* was recission. The policy was subsequently extended to damage actions in *Young v. The Seaboard Corporation*, 360 F. Supp. 490 (D. Utah 1973):

> "There is no reasoned basis for concluding that a plaintiff's stake in the outcome of the suit, i.e., his standing, depends upon whether retrospective injunctive relief rather than damages is necessary to cure his injury. Such a distinction is impractical and would soon be eroded. [citing cases] While suits in equity do not raise the conceptual difficulties of properly limiting damages claims, these difficulties may generally be reduced to those found customarily in tort and rule 10b-5 law by applying the *Vincent* courts causality requirement. They are better resolved through an application of the law of damages, as the *Vincent* court's causality approach suggests, rather than through the erection of standing barriers supposedly anchored in the statute itself but which are frequently elbowed aside. In the opinion of this court, the *Vincent* decision suggests that any person, not just one seeking equitable relief, who shows a causal connection between the fraudulent sale of a security and injury to himself may sue under rule 10b-5." (360 F. Supp. at 494-95)

The Tenth Circuit denied an application for interlocutory appeal July 19, 1973.

Petitioners' alleged conflict is transparent. Some circuits, like the Second, Third, and Fifth, purport to accept the *Birnbaum* purchaser-seller limitation, but then extend 10b-5 protection by treating persons as purchasers or sellers even though they are not, as in the recent decision in *Smallwood v. Pearl Brewing Co.*, 489 F. 2d 579, 489-590, 592 (5th Cir. 1974). Other circuits, like the Eighth, Ninth and Tenth are moving toward a causational approach. The recent decisions of the Sixth and Seventh circuits look more to the purpose of Rule 10b-5 and the class of persons to be protected by the Rule. *To a circuit*, however, the answer to the question presented by petitioners is the same. Persons who are neither purchasers nor sellers of securities are allowed to maintain 10b-5 actions.

The decision in this case is not in conflict with the decisions in other circuits. Whatever differences may exist are in the phrasing, not the result. Contrary to petitioners' second argument, the result in this case does not go as far as other decisions. The "forced seller" cases and the "abortive seller-purchaser doctrine" go further. The "contractual relationship" that was missing in *Mount Clemens* or the "direct dealing" that was missing in *Rekant* is present in this case, and without going as far as they have in other decisions, all of the circuits would have reached the same result in this case as the Seventh Circuit reached.

Eason and Satrom are well within the confines of the class of persons protected by §10(b) and Rule 10b-5 as extended by every other circuit. Petitioners do not present a question which this Court need review. Every circuit that has considered the question has responded in the affirmative.

2. The Decision is Correct for Reasons Other Than Those Challenged by Petitioners.

The Guaranty was issued by shareholder-investors as part of a single transaction involving the purchase of the buiness of Waite Leasing in exchange for the Notes, the Guaranty and 7,000 shares of the common stock of Bank Service.

The Notes are specifically included in the definition of "security" in the Act [15 U.S.C. 78c(a)(10)] and in each of the other five federal securities acts, the Securities Act of 1933 [15 U.S.C. 77b(1)]; the Public Utility Holding Company Act of 1935 (15 U.S.C. 79b(a) (16)]; the Trust Indenture Act of 1939 [15 U.S.C. 77ccc(1)]; the Investment Company Act of 1940 [15 U.S.C. 80a-2(a)(36)]; and the Investment Advisers Act of 1940 [15 U.S.C. 80b-2(a) (18)c].

In all but the Act, the guaranty of such a note is also specifically defined as a security. This exclusion does not mean, however, that guaranties are therefore precluded from being securities under the Act. *Tcherepnin v. Knight*, 389 U.S. 332 (1967); *Sanders v. John Nuveen & Co., Inc.*, 463 F. 2d 1075 (7th Cir. 1972), *cert denied*, 409 U.S. 1009 (1972); *cf. Lawrence v. Securities & Exchange Commission*, 398 F. 2d 276 (1st Cir. 1968). As stated in *Tcherepnin:*

> "The Court of Appeals thought it highly significant that the term 'evidence of indebtedness' appears in the definition of security in the 1933 Act but was omitted from the definition in the 1934 Act. We cannot agree that the omission has any controlling significance in this case." (389 U.S. at 344)

As further stated in *Tcherepnin*, "form should be disregarded for substance and the emphasis should be on eco-

nomic reality." (389 U.S. at 336) The economic reality in this case is that the Guaranty had the characteristics and attributes of other securities. It was a promise to pay money just as the Notes (or, for example, the withdrawable capital shares involved in *Tcherepnin*) evidenced promises to pay money. GMAC was an investor in those Notes; that was its business. GMAC would not have made that investment without the issuance of respondents' Guaranty.

There was but one transaction challenged. In that transaction, Eason and Satrom issued the Guaranty along with the issuance of the Notes and the common stock of Bank Service. These securities, the Guaranty, the Notes and the stock, were the securities that were issued in exchange for the business of Waite Leasing. If the fraud had run the other direction, petitioners would have had a 10b-5 action based on their purchase of securities. It was petitioners' fraud, however, that tainted the acquisition of the business of Waite Leasing. It is difficult to perceive that respondents, who are the real parties in interest and have suffered the greatest damage as a result of that fraud, do not have a 10b-5 action against petitioners.

There is no question that respondents "sold" and GMAC "purchased" the Guaranty. Petitioners have only contended that the Guaranty is not a "security" under the Act. To uphold that contention would be to shrink the protection provided by the Act as compared to all other federal securities acts and would ignore the economic realities of the challenged transaction.

Respondents were purchasers or sellers of securities. They sold their Guaranty, which is a "security", to GMAC. They are being sued on the basis of an alleged contractual obligation to pay certain amounts remaining due under the Notes, which are "securities". As real

parties in interest, they were indirect sellers of the 7,000 shares of Bank Service stock and are entitled to maintain a private 10b-5 action just as the trust beneficiary was held to be entitled to maintain an action in *James v. Gerber Products Co., supra.* As a result of petitioners' fraud, the nature of respondents' investment changed from one in a going enterprise to one in a defunct corporation, and they are every bit as much sellers of their own Bank Service stock as the "forced seller" plaintiff in *Dudley v. Southeastern Factor & Finance Corp., supra.* Just as the opinion below concludes that petitioners would not "dispute a federal court's jurisdiction to entertain an appropriate claim by the corporation, Bank Service," (App. I at A 4) respondents are entitled to maintain a derivative action on behalf of that corporation.

Petitioners' question presented is inapplicable. The opinion below is correct for reasons not challenged by petitioners and should not be reviewed by this Court.

3. The Questions Presented Have Been Settled by This Court.

The conclusion that the Guaranty is a security under the Act flows inevitably from this court's decision in *Tcherepnin.* The fact that respondents issued and sold that security entitles them to maintain their 10b-5 action. The fact that respondents have an alleged contractual liability with regard to the Notes also entitles respondents to maintain the action.

Even if the only question presented was as set forth by petitioners, that question too has been settled by this Court. *Bankers Life* put to rest the basic holding in *Birnbaum* that §10(b) was directed solely at practices "usually associated with the sale or purchase of securities" (193 F. 2d at 464). Judge Stevens correctly concluded that:

> "As Judge Sprecher demonstrated in *Jannes v. Microwave Communications, Inc.*, 461 F. 2d 525, 528-530 (7th Cir. 1972), the basic holding of *Birnbaum* was repudiated by a unanimous Supreme Court in the *Bankers Life* case. We are convinced that the purchaser-seller limitation is nothing more than an appendage to that holding without independent justification." (App. I at A 13)

If §10(b) and Rule 10b-5 were to be substantively limited to preserving the integrity of the securities markets, then the purchaser-seller limitation might have a rational basis. There might be some logical justification for requiring a plaintiff personally to have bought or sold securities in the market before he would be entitled to maintain a 10b-5 action. At best, however, the purchaser-seller limitation cannot be justified other than as an appendage to the substantive limitation judicially imposed on §10(b) by *Birnbaum*. When *Bankers Life* stripped away that substantive limitation this Court, in effect, removed the purchaser-seller limitation. Any conclusion to the contrary would impose artificial "standing" barriers that do not exist in any other area of the law.

Statutes are consistently enforced in favor of the class of persons the statute is designed to protect. The language of §10(b) of the Act specifically establishes that it is designed "for the protection of investors." Thus, petitioners' effort to shift the emphasis away from this Court's choice of words "as an investor" (Petition at 15, 16) cannot be reconciled with the language of the statute. Nor can it be reconciled with the references to "*any* person" in Rule 10b-5. *Cf. Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972).

This Court has passed upon *Birnbaum*. It should not, so soon, be called upon to again pass upon *Birnbaum*. If

the Courts of Appeals, or any of them, were adhering to a strict purchaser-seller standing requirement, it could perhaps be argued otherwise. This is not the case.

As Judge Stevens correctly concludes, this Court has in fact settled *Birnbaum*.

CONCLUSION

For the reasons stated, this Court should not review this case.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1323

GENERAL MOTORS ACCEPTANCE CORPORATION AND DAVE WAITE PONTIAC, INC.,
Petitioners,

vs.

WILLARD D. EASON, M. O. SATROM, AND JEAN M. SATROM,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITIONERS' REPLY BRIEF

Respondents' brief in opposition to petitioners' request that a writ of certiorari to the United States Court of Appeals for the Seventh Circuit issue in this case presents essentially three arguments for denial of the petition for a writ of certiorari—namely, that there is in fact no conflict between the decision of the Seventh Circuit here and the decisions of other courts of appeals; that the issue decided by the Seventh Circuit has already been authoritatively resolved by this Court; and that other grounds exist for the decision of the Seventh Circuit which make the question presented by the petition inapplicable and which, in any event, will necessarily have to be considered by this Court upon full review of this case thereby making review

inappropriate. As will be seen, each of these arguments is devoid of merit. Consequently, the petition for a writ of certiorari of the Seventh Circuit in this case should be granted.

1. Respondents' Contention That the Decision in This Case Is Not in Conflict with the Decision of Other Courts of Appeals Approving the Birnbaum Doctrine.

Respondents argue that no conflict exists between the decision of the Court of Appeals for the Seventh Circuit expressly rejecting the purchaser-seller limitation, first announced in *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461 (2d Cir.), *cert. denied*, 343 U. S. 956 (1952), and the decisions of other courts of appeals which have expressly refused to reject that limitation. This argument is predicated upon the erroneous assumption that the liberalized interpretation of *Birnbaum*—to which respondents refer as "references of fealty to *Birnbaum*" and to which the Seventh Circuit has referred as continuing "to pay homage to *Birnbaum*"—is a mere subterfuge adopted by other courts of appeals to conceal the fact that in reality they also have rejected *Birnbaum* sub silentio. The recent decision of the Fifth Circuit in *Smallwood* v. *Pearl Brewing Co.*, 489 F. 2d 579 (5th Cir. Feb. 19, 1974) is directly responsive to this contention.

In discussing that decision, respondents state:

> "Some circuits, like the Second, Third, and Fifth, purport to accept the *Birnbaum* purchaser-seller limitation, but then extend 10b-5 protection by treating persons as purchasers or sellers even though they are not, as in the recent decision in *Smallwood* v. *Pearl Brewing Co.*, 489 F. 2d 579, 590, 592 (5th Cir. 1974)." (Br. in Opp., at 14).

Yet in *Smallwood*, Judge Wisdom, speaking for the court, in fact said:

> "A. *Rule 10b-5*—Rule 10b-5 has a specific and narrow task—to protect purchasers and sellers of securities from fraud perpetrated 'in connection with the purchase or

> sale of any security.' In Birnbaum v. Newport Steel Corp., 2 Cir. 1952, 193 F. 2d 461 cert. denied, 343 U. S. 956 . . ., the Second Circuit refused standing under the Rule to plaintiffs who were not alleged to be either purchasers or sellers of securities. This Court has consistently followed the *Birnbaum* rule. See Hooper v. Mountain States Securities Corp., 5 Cir. 1960, 282 F. 2d 195, 201, cert. denied, 365 U. S. 814 . . .; Rekant v. Desser, 5 Cir. 1970, 425 F. 2d 872, 877; Herpich v. Wallace, 5 Cir. 1970, 430 F. 2d 792, 806. We are persuaded, moreover, that, at least with respect to actions for damages, *Birnbaum* maintains its vitality in most circuits. See, e.g., Iroquois Industries, Inc. v. Syracuse China Corp., 2 Cir. 1969, 417 F. 2d 963, 968; Greenstein v. Paul, 2 Cir. 1968, 400 F. 2d 589, 581; City National Bank v. Vanderboom, 8 Cir. 1970, 422 F. 2d 221, 228, cert. denied, 399 U. S. 905. . . . *But see Eason* v. *General Motors*, 7 Cir. Dec. 28, 1973, 42 LW 2358 F. 2d .....
>
> ". . . To prevent the *Birnbaum* doctrine from limiting too severely the ability of Rule 10b-5 to meet the broad purposes of the Act, 'seller' has been stretched beyond its common law sense. See, e.g., Hooper v. Mountain States Securities Corp., *supra* (corporation issuing its own stock); Vine v. Beneficial Finance Co., 2 Cir. 1967, 374 F. 2d 627, cert. denied, 389 U. S. 970 . . . (short-form merger). For our present purposes, the most important extension of the Rule 10b-5 definition is the treatment of a merger as a purchase or sale." 489 F. 2d at 589-90 (emphasis added).

Thus, the Court of Appeals for the Fifth Circuit not only clearly recognizes a conflict between its own decisions and this case, but also states in effect that it is persuaded that *Birnbaum* retains its vitality in most circuits, notwithstanding the views of the Seventh Circuit. If other courts of appeals which have held that *Birnbaum* retains its vitality follow Judge Wisdom's view, it would appear that the increase in the workload anticipated by Judge Stevens as a result of the complete abandonment of *Birnbaum* will fall exclusively on the Seventh Circuit, at least until the conflict is resolved by this Court.

The principle underlying the liberalized interpretation of *Birnbaum* was stated by this Court in *SEC* v. *National Securities, Inc.*, 393 U. S. 453, 466-67 (1969) (emphasis added):

> ". . . The meaning of particular phrases must be determined in context, *SEC* v. *C. M. Joiner Leasing Corp.*, 320 U. S. 344, 350-351 (1943). Congress itself has cautioned that the same words may take on a different coloration in different sections of the securities laws; both the 1933 and the 1934 Acts preface their lists of general definitions with the phrase 'unless the context otherwise requires.' 1933 Acts, § 2, 48 Stat. 74, 15 U. S. C. § 77b; 1934 Acts, § 3, 48 Stat. 882, 15 U. S. C. § 78c. We must therefore address ourselves to the meaning of the words 'purchase or sale' *in the context of § 10(b).* Whatever these or similar words may mean in the numerous other contexts in which they appear in the securities laws, only this one narrow questions is presented here. . . .
>
> ". . . Whatever the terms 'purchase' and 'sale' may mean in other contexts, here *an alleged deception* has affected individual shareholders' decisions in a way not at all unlike that involved in a typical cash sale or share exchange."

Against this background, it is clear that what the courts of appeals approving *Birnbaum* have been saying is not that persons who are neither sellers nor purchasers of securities may nevertheless have standing to maintain 10(b) actions, but that persons may be deemed to be purchasers or sellers of securities for purposes of § 10(b), although they are not purchasers or sellers in the common-law sense or in the usual and ordinary sense, in order "to prevent ingenious minds from deflecting the statutory purposes of Section 10(b)," 489 F. 2d at 590, and to ensure "that the broad design of the section and the rule is not frustrated by the use of novel or atypical transactions," 430 F. 2d at p. 807.[1]

1. Indeed, the contention that the *Birnbaum* doctrine has been so eroded by cases applying the liberalized interpretation of *Birnbaum* that it no longer has vitality is not new. It was expressly made and rejected in both *Iroquois Industries, Inc.* v. *Syracuse China Corp.*, 417 F. 2d 763 (2d Cir. 1969), *cert. denied*, 399 U. S. 909

Respondents' statement to the effect that the Seventh Circuit in this case has merely extended the liberalized interpretation of *Birnbaum* with different phrasing is untenable. (Br. in Opp., at 14.) Under the Seventh Circuit's opinion here, the only purchase or sale of a security involved in connection with a possible § 10(b) violation was Bank Service's sale of its stock to Waite Leasing, and the Court of Appeals expressly rejected respondents' contention that they should be characterized as "sellers" of that stock (App. I, p. A3). Moreover, petitioners are unaware of and respondents do not cite a single prior decision in which individuals such as respondents, who bear only a tangential relationship to the sale of securities as shareholders of the selling party, have been accorded *personal* standing to sue under § 10(b) for alleged fraud in connection with such sale. Certainly it is, in all events, evident from Judge Wisdom's recent opinion in *Smallwood* v. *Pearl Brewing Co.*, 489 F. 2d at 589-90, that the Court of Appeals for the Fifth Circuit is in direct conflict with the Seventh Circuit. It is, in sum, difficult to imagine a case which more clearly than this one presents a conflict between the courts of appeals and which is therefore more in need of this Court's attention.

2. Respondents' Contention That This Court Has Heretofore Passed Upon the Correctness of the Birnbaum Doctrine.

Ignoring the Court's own remarks, respondents seize upon the Seventh Circuit's strained assertions that both aspects of the *Birnbaum* decision—that is, that § 10(b) not only was not intended to reach fraudulent mismanagement of corporate affairs but also could not be invoked by anyone other than a purchaser or seller of securities, 193 F. 2d at 464—were rejected in *Superintendent of Insurance of the State of New York* v. *Bankers Life & Casualty Co.*, 404 U. S. 6 (1971). To demonstrate the clear fallacy of this position, it is necessary only to

(1970), and *Mount Clemens Industries, Inc.* v. *Bell*, 464 F. 2d 339, 341 (9th Cir. 1972).

reiterate the precise parameters of the *Bankers Life* decision as stated by this Court:

> "Petitioner's complaint bases his single claim for recovery alternatively on three different transactions alleged to confer jurisdiction under § 10(b): Manhattan's sale of Treasury bonds; the sale of Manhattan stock by Bankers Life to Bourne and Begole; and the transactions involving the certificates of deposit. *We hold only that the alleged fraud is cognizable under § 10(b) and Rule 10b-5 in the bond sale and we express no opinion as to Manhattan's standing under §10(b) and Rule 10b-5 on other phases of the complaint.* See Kellogg, The Inability to Obtain Analytic Precision Where Standing to Sue Under Rule 10b-5 is Involved, 20 Buffalo L. Rev. 93 (1970); Lowenfels, The Demise of the *Birnbaum* Doctrine: A New Era For Rule 10b-5, 54 Va. L. Rev. 268 (1968)." 404 U. S. at 13-14 n. 10 (emphasis added).

Manhattan Casualty Co., on whose behalf *Bankers Life* was brought, was, in fact, the seller of the Treasury bonds involved in the allegedly fraudulent machinations of the defendants in that case, and thus the decision, limited as it was to the actionability of the alleged fraud "in the bond sale," simply did not require review of the second aspect of *Birnbaum*—the purchaser-seller limitation on standing to sue under § 10(b) and Rule 10b-5. As a consequence, this Court made clear that it did not reach that second aspect of *Birnbaum*, declining to express any "opinion as to Manhattan's standing under § 10(b) and Rule 10b-5 on other phases of the [*Bankers Life*] complaint" that challenged transactions in which Manhattan was not directly involved.

Moreover, despite assertions by both the Seventh Circuit and the respondents that the *Birnbaum* purchaser-seller limitation was a mere "appendage" of the now-rejected *Birnbaum* holding that § 10(b) was not intended to reach fraudulent mismangement of corporate affairs, 193 F. 2d at 464, nowhere is it explained why this is the case. Indeed, the essential fact is that the purchaser-seller limitation has a vitality completely in-

dependent from the other aspect of *Birnbaum*; the purchaser-seller limitation, as a condition to standing to sue under § 10(b) is as compatible with *Bankers Life's* expansive theory of the scope of fraudulent activity actionable under § 10(b) as it is with the *Birnbaum's* more restrictive theory. In either context, the real question for present purposes must be whether Congress intended to extend the protection of § 10(b) (and thereby of Rule 10b-5) to persons who have not purchased or sold securities in a transaction touched by alleged deceptive practices, 404 U. S. at 12-13.

In short, the correctness of the *Birnbaum* purchaser-seller limitation on standing to sue under § 10(b) and Rule 10b-5 is both a question important to judicial administration and application of the Federal securities laws and a question upon which this Court has not heretofore passed.

3. Respondents' Contention That the Decision of the Court of Appeals for the Seventh Circuit Is Correct for Reasons Other Than Those Challenged by the Petition.

Respondents also contended that the question presented by the petition is inapplicable and should not be reviewed by this Court because the decision of the Seventh Circuit is correct for other reasons which they say are not challenged by petitioners. They assert that under the facts alleged here they qualified as "purchasers" or "sellers" of "securities" on a number of bases, thereby satisfying the *Birnbaum* limitation. They argue that the guaranties delivered by them to GMAC are "securities" within the meaning of § 10(b); that in guaranteeing payment of indebtness to GMAC, they effectively contracted to purchase notes upon default of the principals, notes which constitute "securities" within the meaning of § 10(b); that they were "indirect sellers" of the 7,000 Bank Service shares transferred to Waite Pontiac by Bank Service under the sales agreement; and that they are entitled to maintain a derivative action on behalf of Bank Service.

None of these arguments was resolved by the Court of Appeals. Rather, considering "it appropriate to examine the viability of [the *Birnbaum*] rule first," that court assumed "that the only purchase or sale of a security involved . . . was the transfer of the 7,000 [Bank Service] shares . . ." and rejected "the suggestion that [respondents] should be characterized as 'sellers' of that stock." (App. I, p. A3). Since the Court of Appeals then proceeded to hold for respondents solely on the basis that they could maintain an action under § 10(b) notwithstanding they were neither purchasers or sellers of the 7,000 Bank Service shares, it was only that decision which petitioners could properly challenge before this Court in their petition for a writ of certiorari.

Under these circumstances, it is obviously absurb for respondents to suggest that the existence of other arguments not reached by the Seventh Circuit makes the question decided by that court inapplicable and not a proper subject for review by this Court. Respondents' additional arguments would once more have relevance here only if this Court should, upon full review, deem the present basis of the Seventh Circuit's decision—the invalidity of the *Birnbaum* purchaser-seller limitation—erroneous.

In this latter regard, it is also absurd for respondents to suggest that if this Court were to undertake review of the Seventh Circuit's decision, it would ultimately be compelled to resolve these additional arguments presented by them in support of the judgment below. (Br. in Opp., at 203). Plainly, such is not the case.

If review of this case were granted, respondents would, to be sure, be entitled under the established practice of this Court to assert in support of the judgment below any grounds appearing in the record, whether or not such grounds were relied upon or even considered in the lower courts. See, e.g., *Langnes* v. *Green*, 282 U. S. 531, 538-39 (1931); *United States* v. *American Ry.*

Express Co., 265 U. S. 425, 453-36 (1924). But it is, of course, well recognized that this Court can, in the exercise of its legitimate discretion, remand a case to the lower courts for initial consideration of such additional arguments. See e.g., *Aetna Cas. & Sur. Co.* v. *Flowers*, 330 U. S. 464, 468 (1947); *United States* v. *Ballard*, 322 U. S. 78, 88 (1944). Thus, contrary to the respondents' suggestion, "[r]eversal of the opinion [of the Seventh Circuit in this case certainly] would not require a negative response" to each of the additional arguments in support of the judgment below raised by respondents. (Br. in Opp., at 3).[2]

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2. While recognizing, then, the irrelevance of respondents' additional arguments for present purposes, it is nevertheless important to note that certain of those arguments are based upon a distortion of respondents' own pleaded allegations in this case. As to the guaranties and the notes, respondents assert before this Court that they "were induced to execute the agreement pursuant to which Bank Service purchased the business of Waite Leasing in exchange for 7,000 shares of Bank Service stock and, concurrently, to execute the Guaranty which was purchased by GMAC as a condition precedent to GMAC's investment in the Notes." (Br. in Opp., at 3.) Respondents also state that the "Guaranty was issued . . . as part of a single transaction involving the purchase of the business of Waite Leasing in *exchange for the* Notes, the Guaranty and 7,000 shares of the common stock of Bank Service" (Br. in Opp. at 15) (emphasis added); that GMAC was an investor in these notes; and that "GMAC would not have made that investment without the issuance of respondents' Guaranty," (Br. in Opp., at 16). Despite these assertions, it is clear from the record that the transaction at issue—the sale of Waite Leasing to Bank Service—involved neither any issuance or exchange of notes, nor the issuance of guaranties to GMAC.

As shown by petitioners' Statement of the Case which is supported by record references, the only notes involved in the sale were notes, secured by chattel mortgages, previously executed by Waite Pontiac with respect to indebtedness resulting from the purchase of automobiles for its leasing operations. GMAC owned those notes prior to the purchase by Bank Service and continued to own them thereafter. As part of the transaction *between* Waite Pontiac and Bank Service, then, Bank Service, as is alleged in the complaint and shown by the sales agreement, simply assumed Waite Pontiac's liability to GMAC on the existing notes—an act to which GMAC

CONCLUSION.

For the reasons stated in the petition and in this reply brief, it is respectfully submitted that the petition for certiorari should be granted.

Respectfully submitted,

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was not a party and thus clearly cannot be said to make GMAC a purchaser of a security.

To be sure, the sales agreement provided that Bank Service's shareholders would indemnify Waite Pontiac against liability to GMAC on the obligations assumed by Bank Service, and in compliance with this provision, the shareholders, including respondents, executed a guaranty to Waite Pontiac in an addendum to the agreement. But this guaranty to Waite Pontiac is not involved here. The guaranties to GMAC were issued not as a part of the purchase price, but rather, as is clearly alleged in the complaint, pursuant to an independent agreement with GMAC that it would consent to the transfer of the mortgaged assets to Bank Service and would also make future loans to Bank Service, or its subsidiary, provided guaranties of the assumed indebtedness and such future loans by GMAC were furnished. When a bank agrees to extend a line of credit to a borrower, it does not become a purchaser of, or an

investor in, notes evidencing the indebtedness, and by conditioning that line of credit of provision of a satisfactory guaranty, the bank does not become a purchaser of a security consisting of the guaranty or an investor in such guaranty. GMAC's position in the guaranty transaction was no different from that of a bank or other financial institution. And, the situation is not altered because the guaranty was furnished by a shareholder of a corporate borrower.

In attempting to characterize GMAC as an investor in "securities," respondents obviously hope to avoid the impact of *Lino* v. *City Investing Co.*, 487 F. 2d 689 (1973), in which the Third Circuit rejected the contention that a transaction in which notes and cash were given in payment for a franchise agreement constituted a sale or purchase of securities giving rise to an action under § 10(b) when coupled with allegations of fraud:

> ". . . [I]t is our view that the legislation was not intended to cover the transaction which occurred here. All of the definitional sections involved in this case are introduced by the phrase *'unless the context otherwise requires.'* The commercial context of this case requires a holding that the transaction did not involve a 'purchase' of securities. These were personal promissory notes issued by a private party. There was no public offering of the notes, and the issuer was the person claiming to be defrauded. The notes were not procured for speculation or investment, and there is no indication that [City Investing's subsidiary] was soliciting venture capital from Lino.
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> ". . . .
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> "In no way could City Investing be said to have 'purchased' Lino's notes for speculation or investment. City Investing was selling a certain contract right to Lino, not buying his security. It simply lacks common sense to describe the transaction as City Investing purchasing John Lino's security by paying him the right to operate one of its Franchise Sales Centers." 487 F. 2d at 694-95.

Under these principles, the notes involved here clearly were merely ordinary commercial notes issued or to be issued in ordinary loan transactions. And, while guaranties might be deemed "securities" within the meaning of § 10(b) in particular circumstances, cf. *SEC* v. *C. M. Joiner Leasing Corp.*, 320 U. S. 344, 351 (1943), the commercial context of this case certainly compels, as it did in Lino, the further conclusion that the issuance and delivery of the guaranty to GMAC did not involve either a "purchase" or a "sale" of a "security".